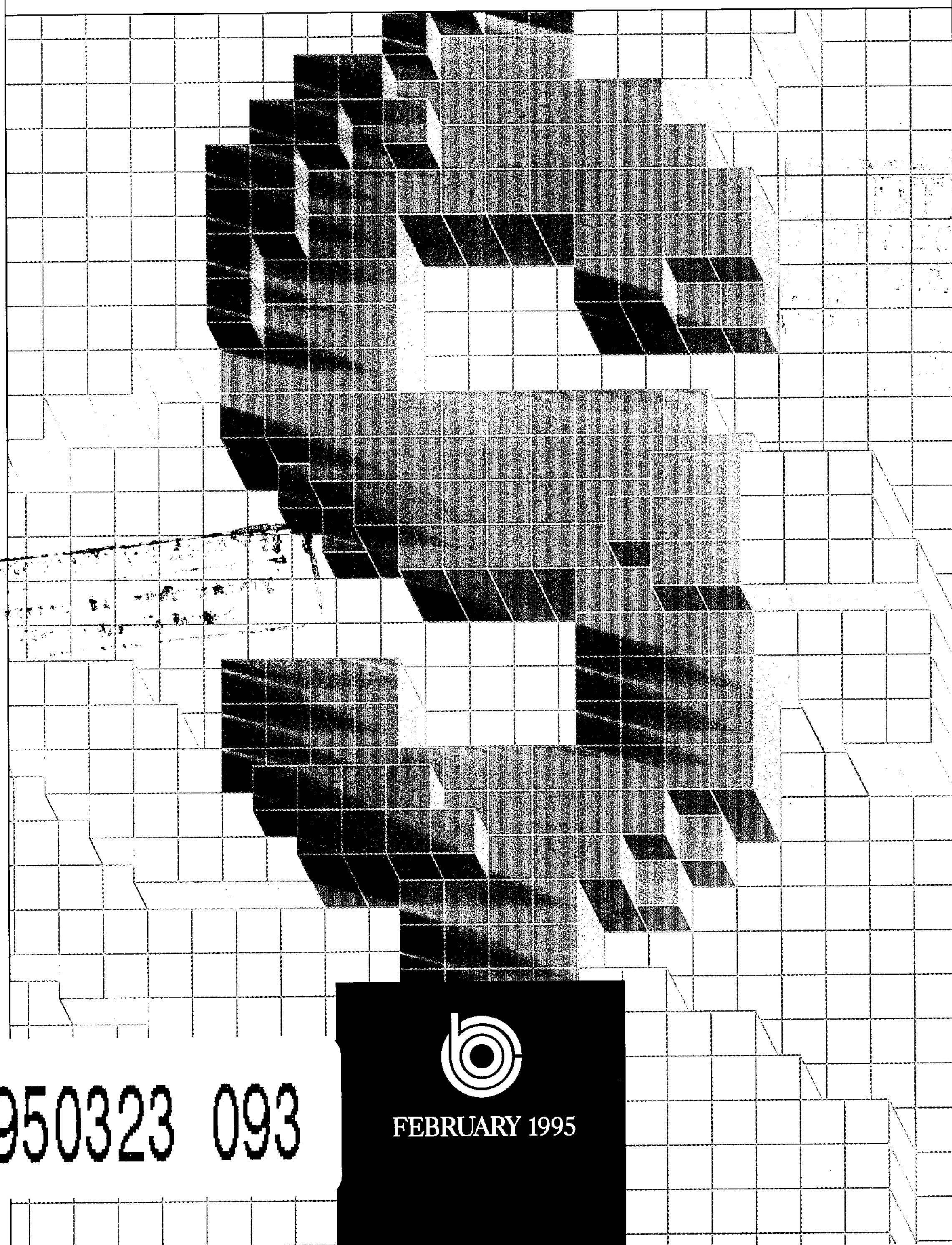
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

Reducing the Deficit: Spending and Revenue Options

A Report to the Senate and House Committees on the Budget

As required by Public Law 93-344



FEBRUARY 1995

REDUCING THE DEFICIT: SPENDING AND REVENUE OPTIONS

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Numbers in the text and tables of this report may not add to totals because of rounding.

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Preface

This volume compiles more than 200 specific policy options for increasing federal revenues or reducing spending in a wide variety of federal programs. This is the 16th such compendium that the Congressional Budget Office (CBO) has prepared as part of its annual report to the House and Senate Committees on the Budget. Over the years, this report has become a standard reference for developing deficit reduction plans.

The 216 specific policy options included in this report come from many sources, and most have been considered by the Congress at some time in the past. In accordance with CBO's mandate to provide objective and impartial analysis, the discussion of each option presents the cases for and against it as fairly as possible. CBO does not endorse the options included, nor does exclusion of any proposal imply a recommendation.

The report begins with an introductory chapter that provides general background information on CBO's latest deficit projections and explains how to use the options presented in this volume. The next three chapters present 177 options for reducing spending, organized by broad categories that have become the focus for deficit reduction efforts--defense and international discretionary spending, domestic discretionary spending, and entitlements and other mandatory spending. The last chapter presents 39 revenue-generating options. The report concludes with an appendix listing the spending options by the budget functions that would be affected and a glossary of budget and economic terms.

The economic assumptions and baseline budget projections underlying the estimates of spending reductions and revenue increases contained in this volume are described in more detail in the first volume of CBO's annual report, *The Economic and Budget Outlook: Fiscal Years 1996-2000* (January 1995).

All divisions of the Congressional Budget Office contributed to this report, which was coordinated by James L. Blum. Philip Joyce prepared Chapter 1. The options presented in Chapters 2 through 5 were coordinated by Mark B. Booth, David H. Moore, R. Mark Musell, Constance Rhind, and R. William Thomas. Budget authority and outlay estimates were coordinated by Paul R. Cullinan, Peter H. Fontaine, Michael A. Miller, William P. Myers, and Murray N. Ross. Revenue estimates were prepared by the staffs of the Congressional Budget Office and the Joint Committee on Taxation and were reviewed by the Tax Analysis Division of CBO under the supervision of Rosemary D. Marcuss.

Paul L. Houts and Sherry Snyder supervised the editing and production of the report. Major portions were edited by Paul L. Houts, Sherry Snyder, Sherwood D. Kohn, and Leah Mazade. Christian Spoor provided editorial assistance during production. The authors owe special thanks to Mary Braxton, Cynthia Cleveland, Sharon Corbin-Jallow, Marlies Dunson, Denise Jordan, Simone Thomas, and Donna Wood, who typed the many drafts. John McCarty and Kathryn Quattrone prepared the report for publication.

Robert D. Reischauer
Director

February 1995

Contents

APPENDIXES

TABLES

FIGURES

BOXES

Chapter One

Using This Volume's Options for Deficit Reduction

Federal policymakers face a difficult set of challenges in 1995. Significant strides in deficit reduction made since 1990 and the economic recovery from the 1990 recession have improved the short-run outlook for the deficit substantially. Nevertheless, the outlook of the Congressional Budget Office (CBO) over the longer term is for a deficit that increases both in nominal terms and as a percentage of gross domestic product (GDP). At the same time, the Congress is considering a proposed balanced budget amendment to the Constitution that could take effect as soon as fiscal year 2002. However, with or without such an amendment, if the budget is to be balanced within the next seven years, the Congress and the President will need to act soon on another round of deficit reduction.

Reducing the deficit is critical because it can significantly affect the ability of the economy to sustain real growth and remain healthy in the long run. Amid a concern that U.S. living standards may grow more slowly in coming decades than they did during most of the postwar period, reducing the budget deficit continues to be an important focus of attention because it will increase national saving. In fact, reducing the deficit is the single most reliable way to improve national saving. Over the long run, a permanently higher rate of saving would lower real interest rates, stimulate new investment, increase productive capacity, enlarge the share of productive investment that would remain with U.S. investors, reduce foreign investment in the United States, and raise the nation's standard of living.

The concern for the deficit and its effect on long-term productivity has provided the impetus for two recent multiyear deficit reduction packages, each of which has involved substantial spending reductions and revenue increases. As a result, the deficit outlook today is much more positive than it would have been without those actions. In 1990, policymakers enacted spending reductions and tax increases that reduced cumulative deficits by an estimated $500 billion over five years. The 1993 budget agreement is estimated to have reduced cumulative deficits by more than $400 billion.[1] Despite that progress, however, the long-run outlook is for the deficit to begin to turn up again late in this century and continue to increase as a percentage of GDP after the turn of the century if present programs and tax laws continue.

The Budget Outlook Through 2005

The Congressional Budget Office projects that the deficit will decline in 1995 for the third year in a row. But according to CBO projections, that trend will then stop. Under current taxing and spending policies, and under CBO's assumptions about the

1. For additional details on the composition of the two deficit reduction packages, see Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options* (March 1994), pp. 4-7.

economy, the deficit will climb again--from $176 billion this year to $207 billion in 1996 and $222 billion in 1998, the last year covered by the limits, or caps, on discretionary spending created by the Budget Enforcement Act of 1990 (BEA) and extended by the 1993 budget agreement. (See Box 1-1 for information about the changes in the budget process made by the Budget Enforcement Act.) As measured by gross domestic product, the deficit will stubbornly hover just around 3 percent for the next five years.

Box 1-1.
The Discretionary Spending Limits and PAYGO

The 1990 deficit reduction package included the Budget Enforcement Act (BEA), whose primary purpose was to ensure that the savings agreed to in the deficit reduction accord would be realized. Since the BEA set up separate enforcement procedures for discretionary spending and for mandatory spending, it is important that readers of this volume understand the differences between those types of federal spending. Discretionary spending is spending controlled through the annual appropriation process, whereas mandatory spending (which includes entitlements such as Social Security and Medicare) represents programs for which the level of spending is not controlled directly, but is driven by the provisions of underlying legislation governing conditions that must be met to receive benefits.

Two major sets of rules for enforcement were included under the BEA. The first of those was the discretionary spending caps on budget authority and outlays for fiscal years 1991 through 1995 (which were extended to 1998 by the Omnibus Budget Reconciliation Act of 1993). Exceeding the caps prompts a sequestration (an across-the-board cut) of discretionary spending. The second major enforcement mechanism included in the BEA is the pay-as-you-go (PAYGO) process. That set of rules requires that legislative actions affecting entitlements and other mandatory spending (excluding Social Security, which has its own limiting rules) as well as revenues must not increase the deficit in any year (originally through 1995, but a subsequent revision extended PAYGO through 1998). If that condition is not met, the PAYGO discipline is enforced through a separate sequestration of the resources available to a prescribed and limited number of mandatory programs, such as Medicare and farm price supports.

The Congressional Budget Act of 1974 requires CBO to prepare five-year estimates of the budget outlook and budgetary legislation. But longer-term extrapolations are critical, particularly in light of the current debate over a constitutional amendment to require a balanced budget. Under current spending and taxing policies, CBO projects that the deficit will top $400 billion in 10 years--more than twice today's level (see Table 1-1). That projection assumes that discretionary spending resumes growing with inflation after 1998, when the caps expire. Because the economy will grow, the deficit will not climb quite as dramatically in relation to GDP. Still, it will inch up fairly steadily--from 2.5 percent of GDP in 1995 to 3.6 percent in 2005.

Why does the deficit grow? Neither discretionary spending, which is projected to decline as a percentage of gross domestic product, nor revenues and nonhealth entitlements (including Social Security) appear to be the culprit. The root cause of growing deficits therefore remains the major health care entitlement programs. Although growth has slowed somewhat, spending for both Medicaid and Medicare is still projected to rise by 10 percent a year through 2005, propelling those expenditures to a combined 6 percent of GDP by that time (up from 3.8 percent today). Those two big health care programs will overtake another entitlement program--Social Security--in size by 2000 and even catch up to total discretionary spending by 2005. In fact, if Medicare and Medicaid were to stay constant as a percentage of GDP instead of increasing, the deficit in 2005 would be only about $90 billion, or 0.8 percent of GDP.

Moreover, between now and 2005, Social Security spending will barely change as a percentage of GDP from today's level of 4.7 percent. In 2005, the final year of that extended projection, the first members of the baby-boom generation will still be several years away from eligibility for Social Security retirement benefits and Medicare. When they do reach eligibility, however, spending for both programs will skyrocket. Thus, the deficit outlook will signifi-

Table 1-1.
The Budget Outlook Through 2005 with Discretionary Inflation After 1998 (By fiscal year)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
In Billions of Dollars											
Revenues	1,355	1,418	1,475	1,546	1,618	1,697	1,787	1,880	1,978	2,082	2,191
Outlays											
Discretionary	544	549	548	547	566	585	605	626	647	669	692
Mandatory											
Social Security	334	352	371	390	411	433	456	481	507	534	563
Medicare	176	196	217	238	262	286	314	344	379	417	460
Medicaid	90	100	111	123	136	149	164	179	196	214	234
Civil Service and Military Retirement	66	68	71	75	80	83	87	91	96	100	105
Other	179	183	192	199	208	220	224	231	239	247	256
Subtotal	845	899	962	1,026	1,097	1,173	1,245	1,328	1,417	1,513	1,617
Deposit insurance	-16	-9	-5	-5	-3	-3	-3	-3	-3	-3	-4
Net interest	235	260	270	279	294	310	325	344	365	387	412
Offsetting receipts	-77	-73	-76	-79	-82	-84	-88	-93	-97	-102	-106
Total	1,531	1,625	1,699	1,769	1,872	1,981	2,084	2,202	2,329	2,465	2,611
Deficit	176	207	224	222	253	284	297	322	351	383	421
Social Security Surplus	69	73	78	84	90	96	104	111	119	128	137
Hospital Insurance Surplus	3	-2	-7	-12	-19	-25	-32	-39	-48	-59	-71
Debt Held by the Public	3,617	3,838	4,077	4,317	4,589	4,891	5,207	5,547	5,917	6,318	6,757
As a Percentage of GDP											
Revenues	19.3	19.2	19.0	19.0	18.9	18.8	18.8	18.8	18.8	18.8	18.8
Outlays											
Discretionary	7.7	7.4	7.1	6.7	6.6	6.5	6.4	6.3	6.2	6.1	6.0
Mandatory											
Social Security	4.7	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8
Medicare	2.5	2.7	2.8	2.9	3.1	3.2	3.3	3.5	3.6	3.8	4.0
Medicaid	1.3	1.4	1.4	1.5	1.6	1.7	1.7	1.8	1.9	1.9	2.0
Civil Service and Military Retirement	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other	2.5	2.5	2.5	2.4	2.4	2.4	2.4	2.3	2.3	2.2	2.2
Subtotal	12.0	12.2	12.4	12.6	12.8	13.0	13.1	13.3	13.5	13.7	13.9
Deposit insurance	-0.2	-0.1	-0.1	-0.1	a	a	a	a	a	a	a
Net interest	3.3	3.5	3.5	3.4	3.4	3.4	3.4	3.4	3.5	3.5	3.5
Offsetting receipts	-1.1	-1.0	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Total	21.8	22.1	21.9	21.7	21.8	22.0	22.0	22.1	22.2	22.3	22.5
Deficit	2.5	2.8	2.9	2.7	3.0	3.1	3.1	3.2	3.3	3.5	3.6
Social Security Surplus	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.2	1.2
Hospital Insurance Surplus	a	a	-0.1	-0.1	-0.2	-0.3	-0.3	-0.4	-0.5	-0.5	-0.6
Debt Held by the Public	51.4	52.1	52.6	53.0	53.5	54.3	54.9	55.6	56.4	57.2	58.1

SOURCE: Congressional Budget Office.
a. Less than 0.05 percent of GDP.

cantly deteriorate beyond even the extended projection period.[2]

Balancing the Budget by 2002

Reducing the deficit substantially is certainly desirable and could also be necessary to comply with the provisions of a proposed balanced budget amendment to the Constitution. Most of the amendments currently being considered provide that the requirements of the amendment would take effect in fiscal year 2002 or the second fiscal year following ratification, whichever is later. CBO estimates that the deficit in 2002, if current policies continue, would be $322 billion. Since a deficit reduction of that size undertaken in one or two years could cause economic disaster, the Congress needs to take further action soon if it wishes to balance the budget or sharply reduce the deficit in the next several years.

In 2002, federal spending is projected to be $2.2 trillion, and revenues are projected to be $1.9 trillion. Of the roughly $2.2 trillion in spending, approximately $1.3 trillion (or 60 percent) would result from outlays for mandatory programs (mostly for Social Security, Medicare, and Medicaid) and $626 billion (28 percent) would stem from discretionary spending. (Defense spending would represent approximately half of the discretionary amount if current spending patterns persist.) The remainder comprises a combination of net interest, deposit insurance, and offsetting receipts.

The task of balancing the budget would become even more arduous if particular options were precluded. For example, some policymakers have indicated a desire to balance the budget without raising taxes, thus implying that deficit reduction would come entirely from cuts in spending. Others have advocated exempting certain categories of spending from budget reduction. Those approaches have implications for the magnitude of the actions that might be necessary to balance the budget.

By way of illustration, consider the magnitude of the policy changes necessary to achieve a balanced budget by 2002. The broadest deficit reduction base would include both spending cuts and tax increases. If half of any reductions necessary to achieve a deficit of zero in 2002 were to come from revenue increases and half from spending cuts (with all spending, except interest on the debt, included in the base), revenues in 2002 would need to be increased by almost 7 percent and spending decreased by approximately the same percentage.

Now consider what would happen if all deficit reductions were to come from spending alone, excluding net interest, offsetting receipts, and deposit insurance. If spending was to be cut across the board, a 13 percent reduction from the projected 2002 level would be necessary to bring spending in line with revenues in that year. If Social Security outlays were excluded from the base that would be subject to spending reductions, the necessary cut in the remainder of the budget would increase to 17 percent. If, in addition to excluding Social Security, defense spending was maintained at real 1995 levels, the required reduction in the remainder of the budget to achieve budgetary balance would increase to 22 percent. The base included for that 22 percent would comprise all non-Social Security outlays for mandatory spending (primarily Medicare and Medicaid) and all nondefense discretionary spending (including all outlays, for example, for veterans assistance, unemployment insurance, law enforcement, highway programs, national parks, space exploration, cancer research, and education assistance).

For illustrative purposes, CBO has laid out one of many possible paths to a balanced budget in 2002 (see Table 1-2). Starting from a baseline that assumes that discretionary spending is adjusted for inflation after 1998 (when the BEA's caps on discretionary spending expire), that path shows the deficit reduction that would be necessary to eliminate gradually the projected $322 billion deficit for 2002.

Over the entire 1996-2002 period, the savings in CBO's illustrative path that result directly from policy changes total more than $1 trillion. When the resulting savings in debt-service payments that will accompany lower deficits are included, the total exceeds $1.2 trillion. That path and the resulting $1.2

2. For more details concerning the underlying economic assumptions and other assumptions used to make these budget projections, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1996-2000* (January 1995).

trillion are illustrative only. The actual amount of cumulative deficit reduction over the 1996-2002 period will depend on the timing and the exact nature of the policies enacted to achieve a balanced budget in 2002.

The required savings from policy changes would be smaller and the debt-service savings greater if, as CBO anticipates, ongoing deficit reduction efforts over this period result in lower interest rates. CBO believes that by 2000 interest rates could be as much as 1 percentage point lower than it currently forecasts if spending cuts and tax increases that would lead to a balanced budget have been enacted and the financial markets are convinced that policymakers will maintain those policies. CBO estimates that such a drop in interest rates would lower projected federal interest payments--and the amount of savings from policy changes needed to balance the budget--by almost $140 billion over the 1996-2002 period.

How to Use This Report

This volume presents a menu of options that can be used to make policy choices to reduce the deficit. Based on their own policy preferences, users of this report can select options that could contribute to decreasing federal red ink. The specific options that are included in this volume came from various sources, such as past Presidential budget proposals, past legislative proposals, and the suggestions of various private groups. CBO staff developed others to illustrate cuts in the broadest possible range of programs and to provide variations of options presented in earlier volumes. In none of these cases is the inclusion of an option intended to communicate its endorsement by CBO. Further, although this particular menu is meant to cover a broad range of options, the exclusion of options does not imply that they lack merit. Finally, variations of these options are also possible.

Table 1-2.
Illustrative Deficit Reduction Path (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	1996-2002
CBO Baseline Deficit with Discretionary Inflation After 1998	176	207	224	222	253	284	297	322	n.a.
Deficit Reduction									
Policy changes[a]	0	-32	-65	-97	-164	-194	-225	-259	-1,035
Debt service	0	-1	-4	-10	-19	-31	-46	-64	-175
Total Deficit Reduction	0	-33	-69	-106	-182	-225	-271	-322	-1,210
Resulting Deficit	176	174	155	116	71	59	26	b	n.a.

SOURCE: Congressional Budget Office.

NOTES: Caps on discretionary spending are set by law through 1998. Measures of the deficit "with discretionary inflation" assume that discretionary spending grows at the rate of inflation after 1998.

n.a. = not applicable.

a. These changes represent only one of a large number of possible paths that would lead to a balanced budget. The exact path depends on when deficit reduction begins and the specific policies adopted by the Congress and the Administration. The path illustrated in this table is not based on any specific policy assumptions but does assume that policies are fully phased in by 1999.

b. Surplus of less than $500 million.

For example, tax rates could be raised by more or less than is contained in a specific option, as could spending. The decision about whether to adopt any of the options is, of course, for elected officials to make.

The policy options for deficit reduction, which include both those that would decrease spending and those that would increase revenues, are presented in the four remaining chapters of this report. Chapters 2 and 3 cover the discretionary programs--national defense (including international programs) in Chapter 2 and domestic programs in Chapter 3. Chapter 4 covers entitlements and other mandatory programs and also presents options that would raise user fees. Chapter 5 discusses a variety of options that would raise tax revenues.

For each option, this volume presents the pros and cons of the proposal, along with estimates of the effect that it would have on the deficit between fiscal years 1996 and 2000. For options covering national defense, mandatory spending, and revenues, the tables present a single set of estimates. For international and domestic discretionary programs, however, most of the options show two sets of estimates. The first indicates how much would be saved compared with projected spending if the 1995 funding level was held constant in nominal terms through 2000. Savings are shown for any year in which the option would result in spending below the 1995 funding level of the program.

The second set of numbers shows how much would be saved compared with the 1995 appropriation level adjusted for inflation through 2000. Thus, the baselines used for estimating savings for individual options do not incorporate the overall limits on spending for discretionary programs imposed through 1998 by the Budget Enforcement Act. Those limits were reflected in the estimates for discretionary spending presented in Table 1-1.

Specific Uses to Which the Options Could Be Put

Many possible uses exist for the options presented in this volume. For example, options in Chapters 2 and 3 could assist the Congress and the Administration in complying with the limits on discretionary spending that exist through 1998. Since those limits would not permit discretionary spending to grow as rapidly as inflation, the options that contemplate cuts in discretionary spending might be used to assist in meeting the existing targets. Users who wish to pursue options for that purpose should use the estimates calculated in the category labeled "1995 Funding Level Adjusted for Inflation" for domestic and international discretionary programs. Those savings are also a measure of the reduction in real resources that would result from adopting that option.

Options presented in this volume might also be used to finance tax cuts, as some Members of Congress are contemplating and as the Administration has proposed. Users seeking options that would help pay for reductions in revenues cannot, however, use reductions in discretionary spending as offsets under the BEA's rules. Therefore, all of the options that could be used to pay for tax cuts appear in Chapters 4 and 5.

Finally, options in this volume might be used to construct a large-scale deficit reduction plan such as could be necessary if the budget was to be balanced by 2002. Although estimates are not presented for fiscal years after 2000 because CBO does not produce a detailed baseline beyond five years, nonetheless users might want to use this volume to select deficit reduction options that move the federal government within striking distance of a balanced budget by 2000, so as to be able to hit the target by 2002.

The illustrative path presented in Table 1-2 results in a deficit of $59 billion in 2000. The size of the policy changes necessary to meet that target in 2000 differs depending on the starting point (see Table 1-3). If users start from a baseline that assumes that discretionary programs grow with inflation after 1995, $722 billion in policy changes would be necessary between 1996 and 2000 to meet the $59 billion target in 2000 (another $86 billion in debt-service savings are assumed to accrue from the reduced deficits). Users who start from that baseline should use the estimates calculated from the category titled "1995 Funding Level Adjusted for Inflation" for the international and domestic discretionary options. Note that this baseline represents higher discretionary

spending, and therefore higher deficits, than the baseline presented in Tables 1-1 and 1-2, since it does not assume compliance with the BEA's caps for 1996 through 1998.

Alternatively, some policymakers have suggested that the starting point for deficit reduction should already assume a freeze in discretionary spending through 2000. The dollar value of additional policy reductions required from such a baseline to meet the $59 billion target would be $485 billion (another $59 billion in debt-service savings would accrue under this option). But using a freeze as a starting point means that readers should use the savings estimates computed from the "1995 Funding Level" category accompanying the international and domestic discretionary options in Chapters 2 and 3. Users should also keep in mind that, by implicitly choosing a starting point that assumes a freeze on all discretionary spending through 2000, they are assuming at the start that there will be a real reduction of $237 billion in discretionary resources over the five years from the level that would be implied by an inflation-adjusted baseline. Moreover, unless gains in efficiency are

Table 1-3.
Deficit Reduction Necessary to Meet Illustrative Path Under Different Baseline Assumptions, 1996-2000
(By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	1996-2000
Savings from Baseline Assuming Discretionary Inflation[a]							
Baseline Deficit	176	212	251	270	306	342	n.a.
Deficit Reduction							
Policy changes	0	-37	-91	-141	-210	-242	-722
Debt service	0	-1	-6	-13	-25	-41	-86
Total Deficit Reduction	0	-39	-96	-154	-235	-283	-808
Resulting Deficit	176	174	155	116	71	59	n.a.
Savings from Baseline Without Discretionary Inflation[b]							
Baseline Deficit	176	201	222	220	233	242	n.a.
Deficit Reduction							
Policy changes	0	-26	-63	-95	-145	-156	-485
Debt service	0	-1	-4	-9	-17	-28	-59
Total Deficit Reduction	0	-27	-67	-105	-162	-183	-544
Resulting Deficit	176	174	155	116	71	59	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. Baseline assumes current law for mandatory spending and revenues and an annual increase in discretionary spending for inflation from 1995 levels.

b. Baseline assumes current law for mandatory spending and revenues and a freeze on all discretionary spending at 1995 levels.

sufficient to compensate for increases in prices, freezing spending at the 1995 level would require a decrease in a program's services or benefits.

Recent Clinton Administration defense plans could be used as a source for part of the savings needed to bridge the gap between the inflation-adjusted baseline and the baseline without discretionary inflation. Compared with the inflation-adjusted baseline, for example, the Administration's 1995 budget plan (as modified by the Congress) would have reduced outlays for defense by $12 billion in 1996, $20 billion in 1997, and $139 billion over the 1996-2000 period (see Table 2-3 on page 17 for additional details). Consequently, real reductions of an additional $100 billion over the five-year period in nondefense discretionary would be needed to reach the frozen 1995 spending level. If users did not choose to employ the defense reductions implicit in the President's plan of a year ago, they would need to make larger reductions in nondefense discretionary spending.

Other General Caveats in Using This Volume

Users of *Reducing the Deficit* should note several other caveats. First, although all of the options, if devoted to deficit reduction, would reduce federal interest costs, those savings are not included in the calculations accompanying the individual options. Ordinarily, when CBO is presented with a detailed budgetary plan, the savings for each option are assessed as in this volume, then the additional interest savings are computed (as is done in the illustrative paths shown in Tables 1-2 and 1-3). Moreover, when such budget packages are put together, one can adjust for any interactions among the parts that would raise or lower the savings--something that cannot be done for the options discussed here. The estimates also do not take into account the possible gains or losses in GDP or decreases in interest rates associated with large-scale deficit reduction. Instead, all options are examined using CBO's current economic projections.

Second, if used for deficit reduction, virtually all of the options presented here would in isolation reduce employment temporarily. Accordingly, that particular drawback is not noted in each discussion. Similarly, all of the proposals to reduce grants to state and local governments would make their financial status worse, and that effect also is not repeated in each discussion.

Third, some options may not be scored as meeting the Budget Enforcement Act's requirements for implementation, even though the options would reduce the deficit. The BEA created separate enforcement mechanisms for discretionary spending, Social Security, and revenues and other mandatory spending. An example of an option that would reduce the deficit but would not count under the Budget Enforcement Act would be a reduction in Social Security spending, which would not enter either the discretionary or pay-as-you-go (PAYGO) calculus, since Social Security was given its own limiting rule in the act. Generally, if the savings cannot be counted under the BEA, that caveat is noted in the discussions of individual options.

Fourth, "credit" is not given in the savings estimates for sales of government assets, such as buildings or land. Asset sales have not been scored as reducing the deficit since 1987, when the Balanced Budget and Emergency Deficit Control Reaffirmation Act prohibited such scoring; its rationale was that the sale of assets did not permanently affect the deficit. Thus, although government assets are sold from time to time, such sales cannot be counted to determine compliance either with the discretionary spending limits or with PAYGO. For that reason, CBO has included no proposals in this volume for which the sale of assets would yield the only savings. That choice was made mainly because the proceeds from such sales cannot be scored under current budget law; no judgment is implied concerning the desirability of selling government assets. In fact, at least one option is included that involves the sale of a government asset because the sale of that asset carries with it other savings that result from a reduction in direct appropriations.

Finally, subsequent CBO cost estimates, which are required to accompany any bill reported by a Congressional committee (with the exception of tax bills, for which estimates of the Joint Committee on Taxation are required by law) may not exactly match the numbers shown in this report. The reason is that policy proposals on which the cost estimates are

based may not precisely match the specifications used in developing the options in this volume. Furthermore, future estimates may be compared with baselines that are different from the one used for the estimates that follow in this volume.

What Is Not Included in These Options

For the most part, the options in this report are those in which savings would occur within the five-year window covered by the budget process. Other proposed actions, although they could certainly result in substantial deficit reduction, are beyond the scope of this report and therefore not included. Two of those proposals that have received considerable attention can serve as examples.

- Redefining the role of the national government within the federal system could have wide-ranging, long-term impacts on federal, state, and local budgets. Ultimately, it could involve a wholesale reexamination of both revenue sources and functional responsibilities at all three levels. But such a plan would be extremely broad in scope and therefore could not easily be presented as a deficit reduction option in this volume.

- Some fundamental changes in the financing of and structure of mandatory programs, including such options as increasing the retirement age for Social Security, were recently considered by the President's Bipartisan Commission on Entitlement and Tax Reform. Such options would also be difficult to present in this report.

Rethinking Federalism

Faced with a governmental system in which all three levels of government--federal, state, and local--are increasingly responsible for delivering services in the same policy areas (such as education, criminal justice, transportation, and health), some proposals have been advanced for a radical restructuring and clarification of the roles of the three levels of government. Such proposals advocate a "sorting out" of responsibilities among the three levels. To illustrate, one proposal would divide responsibility by:

- Giving the states responsibility for public investment to improve productivity in areas such as education and training and public infrastructure;

- Eliminating most federal programs in education, housing, highways, social services, economic development, and job training. Those functions would be carried out by lower levels of government; and

- Giving the federal government sole responsibility for programs for health care, including adopting a plan that would ensure basic coverage for all citizens while controlling the growth in health care costs.[3]

A plan as ambitious as that one would clearly have broad implications for federal taxes, spending, and the deficit. Since it encompasses a wide range of options that are interrelated, however, no such proposal is included in this volume. It is excluded solely because of its scope and not because it is unworthy of consideration.

Reforming Entitlement Programs

The President's Bipartisan Commission on Entitlement and Tax Reform issued its final report to the President in late January. Although the commission was unable to agree on a comprehensive set of recommendations to reform federal entitlement programs, several of the commissioners did endorse specific ideas that would attempt to help solve the long-term entitlement problem.

Among the recommendations that would have a long-term effect on entitlement spending was one to increase the age at which a Social Security recipient would be eligible to receive full benefits. In particular, one proposal would raise that age from 67 to 70, phased in over a period of 30 years. In addition, the

3. Alice Rivlin, *Reviving the American Dream* (Washington, D.C.: Brookings Institution, 1992), p. 17.

eligibility for Medicare would be gradually increased from age 65 to age 70. Both of those changes, though they could have a substantial effect on long-term deficits, would have the majority of their effects outside of the five-year estimating window used for this volume and therefore are not included. Those and other structural changes in major entitlements that would have long phase-in periods (such as changing the way in which benefits are calculated for higher-income recipients or changing the calculation for cost-of-living allowances after the turn of the century) are not included because their major budgetary effects would occur beyond the five-year projection period.[4]

4. For a discussion of these and other options, see President's Bipartisan Commission on Entitlement and Tax Reform, *Final Report* (January 1995).

Chapter Two

Defense and International Discretionary Spending

The collapse of the Soviet Union has presented both an opportunity and a challenge to policymakers in the defense and foreign policy arena. The opportunity has been to reduce the share of the nation's resources devoted to defense. Defense cuts were a major element of the deficit reduction packages passed by the Congress in 1990 and 1993. As a share of gross domestic product (GDP), defense outlays accounted for 5.9 percent in 1989. According to the Congressional Budget Office's (CBO's) projections, that share will be only 3.8 percent in 1995.

The challenge to policymakers has been to cope with the rising number of civil, ethnic, and tribal conflicts throughout the world. Since Operation Desert Storm ended, U.S. military forces have been deployed to Somalia and Haiti, have provided humanitarian assistance to the Kurdish people of northern Iraq and to refugees from Rwanda, and have participated in the North Atlantic Treaty Organization's support activities for the United Nations peacekeeping mission in Bosnia. Spending for the peacekeeping and humanitarian activities of the U.S. military and the United Nations (of which the United States pays nearly one-third) have represented significant, unbudgeted claims on the Departments of Defense and State.

This chapter presents options for reducing spending for national defense and international affairs (budget functions 050 and 150). Budget authority for national defense for 1995 totaled $262 billion. The Department of Defense's (DoD's) military functions accounted for $252 billion, or 96 percent; the remainder consisted primarily of nuclear weapons programs administered by the Department of Energy (DOE), including cleanup of nuclear processing facilities. For international programs, the Congress appropriated $20 billion in discretionary budget authority for 1995.

The National Defense Budget

National defense budget authority more than doubled in the early years of the Reagan Administration--from $144 billion in 1980 to $295 billion in 1985--then was held at roughly its 1985 level through 1990 before beginning to decline. But when inflation is taken into account, a different picture emerges. Over the past 10 years, real defense budget authority has dropped sharply, for a cumulative decline of 35 percent (see Figure 2-1).

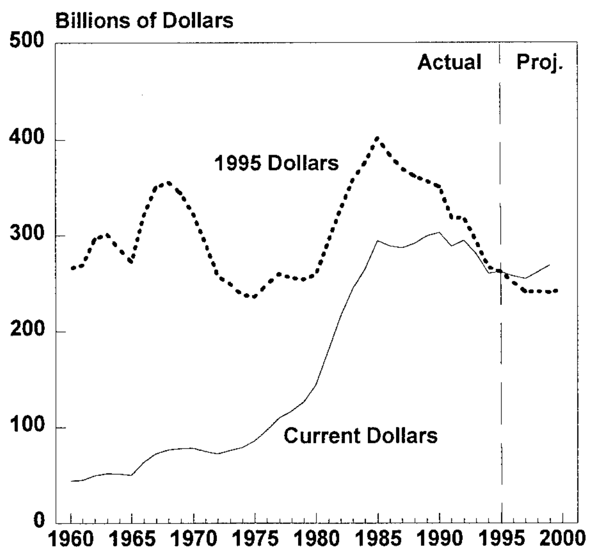
Reductions in the number of military and civilian personnel, the closing of bases, and the cancellation or deferral of many modernization programs largely account for that drop. But savings from eliminating forces have yet to be matched by proportionate decreases in costs for the Department of Defense's extensive infrastructure of bases, supply and repair depots, and other facilities.

Moreover, some parts of the defense budget have continued to grow, even as U.S. military forces have been reduced by one-third. For example, DoD's spending for environmental programs tripled between 1990 and 1994. The Congress has also increased spending on conversion programs to assist workers

and firms displaced by the defense drawdown. In addition, costs for peacekeeping and humanitarian missions have been paid out of operating funds otherwise available for training, thus raising concerns in the Congress that the pace of such activities is harming the military forces' readiness for traditional combat missions.

These and other concerns have led some Members to call for an increase in defense funding. But even if the Congress agrees, budget pressures will continue and may gain force if the balanced budget amendment is adopted (as discussed in Chapter 1). Some options presented in this chapter would reduce military forces or capabilities in specific areas; others would trim spending for support activities. Although this volume focuses on ways to reduce the federal deficit, the savings from these options could be applied in any number of ways. For example, the savings could fund additional spending for higher-priority military functions without increasing overall budgetary allocations for defense.

Figure 2-1.
Budget Authority for National Defense



SOURCE: Congressional Budget Office based on data from the Office of Management and Budget and the Department of Defense.

Assessing Threats to National Security

One aim of U.S. national security policy is to maintain military forces that are powerful enough to deter potential adversaries from attacking the United States directly or to defeat them, should deterrence fail. The collapse of the Soviet Union and the Warsaw Pact removed the single greatest military threat to the United States and its allies in Europe and the Pacific. The United States and the four nations of the former Soviet Union that retain nuclear weapons have ratified the first Strategic Arms Reduction Treaty (START I).

Since 1990, the United States has nearly halved its land-based intercontinental ballistic missile (ICBM) force, reduced the number of strategic bombers from 244 to 107 and taken them off alert status, and retired the last of its Poseidon class missile submarines, reducing the number of sea-based missiles from 584 to 360 (see Table 2-1). Although those are dramatic declines, the U.S. strategic triad of bombers, land-based ICBMs, and Trident submarines still provides a robust deterrent to direct nuclear attack. Some analysts feel that the greatest current threat from nuclear weapons and materials in the former Soviet Union is the likelihood that they could be diverted to other countries, where they might be used in regional conflicts.

Conventional military forces have also been reduced--by a third or more from their 1990 levels. For example, active Army divisions were cut from 18 to 12, Air Force tactical fighter wings (active and reserve) from 36 to 20, and Navy ships from 546 to 373 (see Table 2-1). Those forces are close to the targets set by the Clinton Administration in its Bottom-Up Review.

The Administration's new basis for sizing conventional forces is a scenario in which the United States could become involved in two major regional conflicts nearly simultaneously. Those conflicts would require U.S. forces to deploy abroad to meet a threat directed at a U.S. ally or at a country or countries where vital U.S. or international interests were deemed to be at stake. For planning purposes, the opposing forces in each of the two conflicts are as-

sumed to be on the order of those Iraq had during the Persian Gulf War.

The Administration, in its Bottom-Up Review, determined the forces it believes the United States would need to deploy to win both conflicts. Those forces include 10 active Army divisions, supplemented by eight National Guard divisions and other reserve combat and support units. The Navy would have fewer ships than in 1995, but it would retain the 11 active carrier battle groups plus one reserve carrier for training and local contingencies.

Table 2-1.
U.S. Military Forces (By fiscal year)

	1990	1993	1995	Bottom-Up Review Plan[a]
Strategic Forces				
Land-based ICBMs	1,000	787	550	500
Strategic bombers	244	168	107	154
Sea-launched ballistic missiles	584	408	360	336
Land Forces				
Army active divisions	18	14	12	10
Army reserve component divisions	10	8	8	8
Marine Corps divisions[b]	4	4	4	4
Naval Forces				
Battle force ships	546	435	373	346
Aircraft carriers				
Active	15	13	11	11
Reserve	1	0	1	1
Navy carrier wings				
Active	13	11	10	10
Reserve	2	2	1	1
Air Forces				
Tactical fighter wings				
Active	24	16	13	13
Reserve	12	11	7	7
Airlift aircraft				
Intertheater	400	383	371	327
Intratheater	460	406	388	394

SOURCE: Congressional Budget Office using data from the Department of Defense. Data for 1990, 1993, and 1995 are from Office of the Secretary of Defense, *Annual Report to the President and the Congress* (January 1994). Data for the Bottom-Up Review are from the Fiscal Year 1996 Department of Defense Budget Briefing of the Under Secretary of Defense (Comptroller), February 6, 1995.

NOTE: ICBMs = intercontinental ballistic missiles.

a. The Bottom-Up Review did not provide goals for all types of forces. Estimates of strategic forces are based on the Nuclear Posture Review and airlift forces on the Air Mobility Master Plan, which were completed after the Bottom-Up Review.

b. Includes one reserve Marine Corps divison.

The Air Force's tactical aircraft forces would stay at about their current level.

But the Bottom-Up Review also described a need for improvements in some areas. To deploy forces to both theaters, the Secretary of Defense called for enhancing the strategic mobility forces, including Air Force airlift aircraft, Navy and Ready Reserve Force cargo ships, and prepositioning materiel abroad and at sea. The review also identified needed improvements in such areas as intelligence, communications, and command and control, as well as the procurement of advanced precision-guided munitions.

In 1994, U.S. forces were used in military missions that were very different from and smaller in scale than those in the Administration's planning scenario. For example, U.S. forces participated in the North Atlantic Treaty Organization's support of the United Nations' mission to Bosnia: Air Force and Navy pilots flew missions to enforce the no-fly zone, Navy ships participated in the blockade of military shipments to the warring parties, and Air Force airlift aircraft dropped relief packets of food and medicine. U.S. forces also delivered assistance to refugees who had fled the fighting in Rwanda.

Forces were also active in the Caribbean. Navy forces imposed a blockade on Haiti when its military rulers reneged on their agreement to transfer power to the elected government. Navy and Coast Guard units intercepted and detained Haitian and Cuban nationals seeking to enter the United States. In September, U.S. forces landed in Haiti to restore President Aristide and his government to power.

Force Structure

The Bottom-Up Review established goals for major elements of U.S. forces based on the scenario of fighting two major regional conflicts simultaneously. Some critics reject that scenario altogether, believing that the United States faces greater threats. Others accept the Administration's scenario but believe that the allotted forces are inadequate. Both camps argue against the cuts in forces the Administration is implementing as a result of the Bottom-Up Review. Some military leaders believe that although the reduced forces would be adequate to meet the two-conflict threat, current limitations in airlift and sealift capacities would prevent DoD from deploying the forces in time to defeat a determined and aggressive adversary.

Other military analysts and policymakers believe that the two-conflict strategy overstates the likely magnitude of security risks the United States will face in coming years. They argue that further reductions in military forces are possible with little risk to national security. Also, current U.S. forces are overwhelmingly superior technically to those of any likely adversary. To accommodate those views, additional reductions in military forces are among the options presented in this chapter.

Readiness

Many Members of Congress believe that the rapid pace of peacekeeping operations in 1994 took a toll on military readiness. Emergency operations affect the military in a number of ways. First, units sent abroad on peacekeeping or humanitarian missions are not immediately available for combat elsewhere. Second, their deployment may interrupt or delay their scheduled training for combat, and once the units are deployed, their combat skills may atrophy because their situation does not permit training activities to be conducted. The third factor is a budget issue: military managers must dip into their operating accounts to finance the cost of contingency operations. That can lead to cuts in training for other units not involved in the operation. Supplemental appropriations to pay for the operation may arrive too late to rectify the situation. These specific issues notwithstanding, most of the measures of overall readiness for the services remain near their peak. None of the budget options presented here are directed at reducing readiness.

Modernization

Spending for the acquisition of weapon systems in recent budgets is down more than 50 percent from Cold War levels. The sharp cuts DoD made in its forces has enabled it to terminate or reduce procurement of most ships, planes, and fighting vehicles

without creating a shortage of equipment. But beginning around the end of this decade, DoD will have to resume purchasing many of those items. In the coming decade (2001-2010), CBO estimates that procurement spending will need to average as much as two-thirds more than its 1995 level. Several of the options presented below would either defer or cancel some of the programs responsible for that projected increase.

Although procurement has fallen sharply, DoD acquisition managers have followed a deliberate policy of maintaining a high level of research and development spending through 1994. That policy was seen as key to keeping the United States at the technological forefront for future weapons while production of earlier generations of weapons was coming to a close. But the Administration's budget projections for the rest of the decade suggest that research and development spending will decline considerably through 2000, even as procurement spending rises. That shift will return research and development spending almost to its historical relationship with procurement spending. Some of the options would affect development programs for new weapons. One (DEF-19) would reduce spending for dual-use technology programs.

Roles and Missions

The Congress, in the National Defense Authorization Act for Fiscal Year 1994, established a Commission on Roles and Missions of the Armed Forces. The commission's charter is to review all aspects of the organization of the Department of Defense for possible efficiencies and improvements. It will review such matters as duplication among the services in performing military missions, as well as the consolidation of support activities such as training, maintenance, and intelligence gathering. The commission's report is due in May 1995. Many of the options described in this chapter are drawn from previous CBO analyses of the issues related to the services' roles and missions and may be germane to the debate on this topic.

A Shortfall in the Defense Budget?

Cutting the defense budget has been a primary means of reducing the federal budget deficit. The 1990 deficit reduction package achieved one-third of its total $500 billion reduction through cuts in future defense budgets. And defense cuts accounted for nearly 80 percent of the reductions in discretionary spending in the Administration's 1993 deficit reduction package.

Many Members of Congress now believe that cuts in the defense budget have been too precipitate. They question whether the Administration's planned forces can be adequately supported and modernized with the funds the Administration has allotted. CBO's own review of this issue found that the cost of the 1995-1999 Future Years Defense Program might exceed the Administration's planned defense budgets by $65 billion, or about 5 percent of planned spending. In December 1994, the President announced his intention to increase future defense budgets by a total of $25 billion through 2001. That action, together with the Administration's request for $2.6 billion in supplemental funding to pay for contingency operations in 1995 and DoD's decision to defer or cancel certain weapons modernization programs, has reduced CBO's estimate of the potential mismatch to $47 billion over the 1995-1999 period.[1]

This mismatch between programs and resources is yet another reason to seek efficiencies in the defense budget. Proponents of a stronger military may need to find ways to cut certain elements of DoD spending to finance the additional resources they would like to devote to higher-priority defense activities.

Specific Options for Reducing Defense Spending

The national defense budget the Congress approved for 1995 totals $262 billion in budget authority and

1. For more details on this issue, see Congressional Budget Office, "An Analysis of the Administration's Future Years Defense Program for 1995 Through 1999," CBO Paper (January 1995).

$270 billion in outlays (see Table 2-2). Of the $262 billion in budget authority, $252 billion is for military functions of the Department of Defense, $10.3 billion for atomic energy defense programs and cleanup of nuclear facilities of the Department of Energy, and $0.5 billion for defense activities of other departments and agencies of the federal government.

About $166 billion--nearly two-thirds of DoD's budget--is used for operation and support of military forces. That amount includes $70.4 billion in pay and allowances for military personnel, $92.0 billion for operation and maintenance of the military forces, and $3.4 billion for operating, maintaining, and improving family housing. The remaining third of the budget is for investment spending, including $44.6 billion for procuring weapons and other items of equipment, $35.4 billion for performing research and developing and testing new weapon systems, and $5.5 billion for military construction (see Table 2-2).

Table 2-2.
Discretionary Appropriations for National Defense for Fiscal Year 1995 (In billions of dollars)

	Budget Authority	Outlays
Department of Defense		
Military personnel	70.4	70.6
Operation and maintenance	92.0	88.0
Procurement	44.6	54.7
Research, development, test, and evaluation	35.4	35.1
Military construction	5.5	5.6
Family housing	3.4	3.4
Other	0.3	1.4
Subtotal	251.6	258.8
Department of Energy Atomic Energy Programs	10.3	10.5
Other Agencies and Departments	0.5	0.7
Total	262.4	269.9

SOURCE: Congressional Budget Office.

The 66 percent of the budget that is used for current operations versus the 34 percent for investment is quite high by historical standards--in 1985 the split was 53 percent and 47 percent.

The specific options for achieving efficiencies in and reducing costs for defense programs are grouped according to topic. Options numbered DEF-01 through DEF-19 address changes in investment plans and force structure. Those options include possible reductions in strategic systems, Navy ships, tactical aircraft in the Navy and Air Force, and Army light divisions, as well as other issues related to modernization programs for all of the services.

Options for reducing spending for both military and civilian personnel and for activities that support military forces are presented in DEF-20 through DEF-34. Some of those options would reduce compensation; others would change personnel policies, funding for operation and maintenance, and medical care practices in the military. None of these options are targeted at reducing readiness: instead, they are oriented toward achieving efficiencies in the military infrastructure that supports combat forces.

The table at the beginning of each option displays the five-year savings it would generate in the federal budget. For some options involving significant numbers of military personnel, savings recorded in the DoD budget (budget function 050) would be larger than those in the federal budget because DoD military personnel costs include an accrual charge related to retirement costs. That charge is transferred to the DoD retirement account elsewhere in the budget. Savings from the DoD budget for those options are shown in Appendix A.

A reader may wish to combine several options into a package of deficit reduction measures. Care should be taken not to include options that are mutually exclusive or that may overlap, resulting in the double-counting of savings. Subject to that caution, the resulting effects on future deficits may be estimated as follows.

First, select a baseline from which to start. CBO has projected the baseline deficit under two assumptions regarding discretionary spending: one baseline assumes adjustments for inflation for discretionary

spending after 1995; the other assumes spending is frozen at the 1995 level. Those baselines, together with an illustrative path showing the amount of deficit reduction necessary to achieve a balanced budget by 2002, are shown in Table 1-3 in Chapter 1. CBO's estimates of savings for individual defense options may be applied to either baseline.

Second, decide whether to include the savings in the Administration's 1995 defense plan. Measured against the inflation-adjusted baseline, the 1995 plan generates five-year outlay savings of $139 billion (see Table 2-3, which also shows annual savings). Readers selecting the adjusted baseline can subtract the annual savings from the deficits shown in Table 1-3. (By doing so, the reader implicitly accepts all of the policy actions of the Administration that are necessary to reduce real spending by $139 billion.) From that new amount they can then subtract the additional savings yielded by the options they select from this and other chapters.

Measured against the baseline that freezes spending at the 1995 level, however, savings from the Administration's defense plan are much smaller--only $20 billion over five years (see Table 2-3). The real

Table 2-3.
Alternative Budget Paths for National Defense (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	Total, 1996-2000
CBO's Projections for National Defense						
1995 Funding Level						
Budget authority	263	263	263	263	263	1,315
Outlays	264	264	262	262	261	1,313
1995 Funding Level Adjusted for Inflation						
Budget authority	272	282	291	302	313	1,460
Outlays	270	278	285	295	304	1,432
Administration's Fiscal Year 1995 Plan (as of February 1994)						
Budget Authority	256	252	259	266	272	1,305
Outlays	258	258	257	259	262	1,293
Savings or Costs (-) Associated with the Administration's Fiscal Year 1995 Plan						
From the 1995 Funding Level						
Budget authority	7	11	4	-3	-9	10
Outlays	6	7	5	3	-1	20
From the 1995 Funding Level Adjusted for Inflation						
Budget authority	16	30	32	36	41	156
Outlays	12	20	28	36	42	139

SOURCE: Congressional Budget Office.

Table 2-4.
Discretionary Appropriations for International Affairs for Fiscal Year 1995 (In billions of dollars)

	Budget Authority	Outlays
International Development and Humanitarian Assistance	8.7	8.5
International Security Assistance	5.7	6.5
Conduct of Foreign Affairs	4.1	4.4
Foreign Information and Exchange Activities	1.4	1.5
International Financing Programs	0.5	0.4
Total	20.4	21.2

SOURCE: Congressional Budget Office.

reductions in defense discretionary spending reflected in the 1995 plan, as well as additional reductions in nondefense spending, are needed just to achieve the goal of holding overall discretionary spending at its 1995 level. Readers selecting the frozen baseline can subtract the $20 billion in savings from the deficit projections in Table 1-3 before applying the additional savings that the selected options provide.

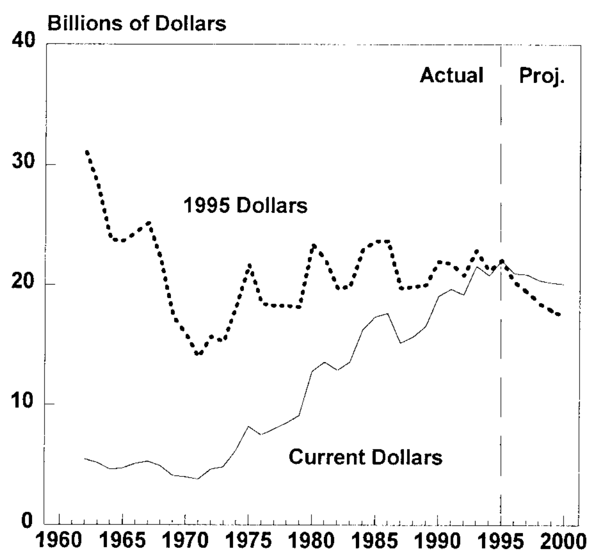
Of course, the Pentagon's plans change from year to year. For some of the options in this chapter, the Administration's new program for fiscal years 1996 through 2001 makes significant changes to the 1995 plan. Those changes may increase or reduce CBO's estimates of savings. Readers using the details of this volume to estimate savings relative to the Administration's fiscal year 1996 budget request for national defense should refer to the savings estimates shown in Appendix B for those options. (If an alternative estimate of savings has been made against the new budget request, a note to that effect appears in the option below the table.)

The International Affairs Budget

Spending for international affairs (budget function 150) is, compared with defense spending, a relatively small component of the total federal budget. The international affairs budget for fiscal year 1995 totals $20.4 billion in discretionary budget authority and results in outlays of $21.2 billion (see Table 2-4 for details of that budget function). Those outlays represent 1.4 percent of total federal government outlays and 3.9 percent of total discretionary outlays in 1995. Altogether, international programs consume 0.3 percent of the nation's gross domestic product.

In the past, the United States has spent a higher fraction of its budget and resources on international programs. In 1962, for instance, spending for international affairs totaled $5.5 billion--equivalent to $31 billion in today's dollars. That amount represented

Figure 2-2.
Outlays for International Affairs



SOURCE: Congressional Budget Office based on data from the Office of Management and Budget.

7.3 percent of total discretionary outlays and 1.0 percent of 1962 GDP. During most of the 1960s, spending for international affairs declined both absolutely and as a share of the budget, reaching a low of $14 billion (in 1995 dollars) in 1971 (see Figure 2-2).

From that level, spending rose by two-thirds in the 1970s, reaching $23.4 billion (1995 dollars) in 1980. Part of that increase reflected much greater levels of economic assistance for Egypt and Israel, agreed to as part of the Camp David Accords. Since 1980, real spending for international affairs has fluctuated within the range of $20 billion to $24 billion. In the 1990s, caps on the category of international spending and, since 1993, on total discretionary spending under the Budget Enforcement Act have tended to limit further growth in this budget function.

Options dealing with the international affairs budget are presented in DEF-35 through DEF-41. Those options cover a variety of topics, including bilateral development assistance and U.S. support to the multilateral development banks, activities of the State Department, exports of military equipment, sales and grants of food under the P.L. 480 program, and U.S. information programs abroad. Savings for each option are presented in two ways: against the 1995 level of funding for the program, and against the 1995 level of funding adjusted for inflation through 2000. Which standard to use depends on the baseline the reader chooses to start with, as discussed earlier in the defense section of this chapter.

DEF-01 REDUCE NUCLEAR DELIVERY SYSTEMS WITHIN OVERALL LIMITS OF START II

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	140	520	610	760	930	2,960
Outlays	-30[a]	80	310	560	790	1,710

NOTES: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The Administration has made significant changes to its 1995 plan for these systems. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

a. Higher outlays from increased bomber operations more than offset savings from other cuts in 1996.

With the end of the Cold War, the nuclear superpowers have begun to scale back the size of their nuclear arsenals. If put into effect, the second Strategic Arms Reduction Treaty (START II), which was completed in 1993, will require that long-range nuclear forces be cut by roughly two-thirds of their 1990 levels by early in the next century. The United States and Russia have begun to plan their nuclear forces within the framework provided by both of the START accords; Ukraine's decision of November 1994 to sign the Nuclear Non-Proliferation Treaty should greatly help to implement both START treaties.

In its plan for fiscal year 1995, the Administration proposed to deploy a strategic force in 2003 with 500 Minuteman ICBMs (intercontinental ballistic missiles, each carrying a single warhead, although they can carry three), 47 B-52H bombers (each carrying 20 warheads), 20 B-2 bombers (each carrying 16 warheads), and 18 Trident submarines (each carrying 96 warheads). Overall, the United States would deploy almost 3,500 warheads--the maximum number allowed by START II.

The 1995 plan has been superseded, however, by the Pentagon's recent review of U.S. nuclear doctrine and forces (the Nuclear Posture Review). This review forms the basis of the Administration's plan for 1996. Like the old plan, the Administration's 1996 plan envisions a force of between 450 and 500 Minuteman ICBMs and 20 B-2 bombers. But the 1996 plan increases the B-52 force by 19 aircraft relative to the 1995 plan and reduces the Trident fleet by four submarines. Under the 1996 plan, the Administration will still deploy almost 3,500 warheads; the plan increases the number of warheads on each Trident missile from four to five and reduces the B-52H loadings to no more than 15 warheads.

This option would keep the same number of warheads that the Administration plans under START II, but it would load the warheads on fewer missiles and submarines and thus would retire some systems that the Administration proposes to retain in its 1996 plan. Under this option, the United States would retire four Trident submarines and 200 Minuteman III ICBMs relative to the 1996 plan (assuming that 500 ICBMs would have been deployed). It would preserve 300 Minuteman III ICBMs (carrying 300 warheads) and 10 Trident submarines, each loaded with 24 missiles. To offset the reduction in Trident missiles, the number of warheads deployed on the Trident force would stay at the level planned by the Administration (1,680) by increasing the number of warheads on each missile from five to seven. Like the Administration's plan for 1996, this option would retain 66 B-52H nuclear bombers, but each would carry 16 warheads for a total of 1,056 warheads. It would also keep 20 B-2 bombers, each loaded with 16 warheads--the same number planned by the Administration. Thus, the total strategic nuclear force proposed in this option would consist of almost 3,400 warheads--roughly 100 warheads fewer than the Ad-

ministration proposes. Furthermore, no weapon system would be deployed with more warheads than it was designed to carry.

Compared with the 1995 plan, this option could save $140 million in 1996 and nearly $3 billion over the next five years. Those savings come from reduced operations and support (O&S) costs and lower levels of investment. The O&S savings reflect the retirement of the ICBMs, although those savings would be offset by the cost of operating more B-52 bombers than called for in the 1995 plan. Investment savings are achieved by canceling D5 missile production after buying 10 missiles in 1996 and extending the service life of fewer Minuteman missiles. Savings from operating four fewer Trident submarines are not reflected in the five-year savings because the submarines would not be retired until after 2000. (DEF-02 describes the savings from the Trident force in more detail.)

Savings would be greater relative to the Administration's 1996 plan because it calls for operating the same number of bombers as in this option, which is higher than called for in the 1995 plan. Also, the 1996 plan includes money that was not included in the 1995 plan to convert C4-capable Trident submarines so that they can carry D5 missiles. This option would cancel those conversions, saving an additional $280 million in 1996 and $4.3 billion over the next five years.

During the Cold War, this option might have raised concerns about stability. By putting more nuclear "eggs" in fewer baskets, the United States would have increased its vulnerability to a surprise attack. But today, with the most destabilizing nuclear modernization programs in the former Soviet Union terminated, fewer weapons at high states of readiness, and the end of the military competition between the North Atlantic Treaty Organization and the Warsaw Pact in Europe, those concerns have become less acute. The United States may now decide that it can save money by deploying its warheads on fewer weapon systems.

This option would also preserve flexibility for future developments. For example, it would retain three types of nuclear systems (the so-called triad), despite the recommendations of some analysts that all ICBMs be retired in order to save money. Retaining all three types provides a margin of security against an adversary's developing a new technology that might render other legs of the nuclear triad more vulnerable to attack. In addition, although ICBMs are considered the most vulnerable portion of the triad, at least a fraction of them would be able to survive virtually any type of attack by any country, even if they had been taken off alert.

Against this option's advantages, the Congress would have to balance a number of disadvantages. Carrying more warheads on bombers and submarines would diminish the targeting flexibility of U.S. planners. Unilaterally reducing the ICBM and ballistic missile submarine forces would also reduce the ability of the United States to increase significantly the number of warheads it deployed in the event that Russia decided suddenly not to abide by START II. Indeed, some critics of this option and the Administration's 1995 plan argue that the United States should not relinquish any capability until Russia has fully complied with START I and ratified START II, because such a unilateral reduction would diminish U.S. leverage to persuade Russia to reduce its forces. Finally, by deploying fewer ICBMs, this option would reduce the forces that could be placed most easily in a nonalert but survivable status, an approach that some analysts have proposed recently to lower the chances of an accidental nuclear war.

DEF-02 TERMINATE PRODUCTION OF D5 MISSILES AFTER 1996

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	80	420	390	420	370	1,680
Outlays	10	80	210	330	370	1,000

NOTE: The Administration has made significant changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

The D5 missile, also called the Trident II missile, is the most accurate and powerful submarine-launched ballistic missile (SLBM) in the U.S. inventory. The result of more than 15 years of research and development, it is the keystone of the Navy's plan to modernize its ballistic missile force. Because of its accuracy and the size of its warheads, the D5 is the first submarine-launched missile that is capable of destroying very hard (or counterforce) targets such as missile silos and command bunkers. That capability will allow the Navy to assume some of the counterforce missions that previously could be carried out only by the Air Force's land-based intercontinental ballistic missiles and long-range bombers.

The Administration's 1995 plan would have deployed a force of 18 Trident submarines starting in 1998. Under that plan, the Navy would have procured a total of 389 D5 missiles and installed 24 of them on each of the 10 newest submarines. The eight older Trident submarines carry the older C4 missile, which is less accurate and has a shorter range than the D5. To support the 10 D5-capable submarines, the Navy has already purchased 337 D5 missiles and planned to buy 12 more in 1996 and a total of 52 through 2000. The C4 missiles are aging, however, and must be refurbished if they are to remain in the fleet. Alternatively, the Navy could modify (or backfit) the C4 submarines to carry D5 missiles. According to its 1995 plan, the Navy intended to wait a while before deciding which course to take. However, that plan did not include money for either option.

The Administration's 1996 plan, which reflects the results of the recent Nuclear Posture Review, assumes that the Navy will reduce the Trident force to 14 submarines by 2003, when the United States must fully implement the second Strategic Arms Reduction Treaty (START II). All 14 submarines will carry D5 missiles. To that end, the Navy will retire four of the C4-capable submarines by 2003 and convert the other four to carry D5 missiles. To support its 1996 plan, the Administration will procure six D5 missiles in 1996 and 91 more through 2005 for a total of 434 missiles. This new objective also reflects a decision by the Navy in the 1996 plan to reduce the number of D5 test flights to roughly four a year from the rate of six a year assumed in the 1995 plan. To keep the number of U.S. warheads near the ceiling allowed by START II, which limits the number of warheads on submarine-launched ballistic missiles to 1,750, the Administration will probably reduce the number of warheads per missile from eight to five (for a total of 1,680 warheads).

This option would terminate D5 production after buying 10 missiles in 1996 for a total of 347--the number that the Navy says it would need to support a 10-submarine force in light of its recent decision to reduce the number of D5 test flights. Accordingly, this option would deploy only 10 submarines equipped with D5 missiles and would eventually retire the eight C4 submarines. Like the Administration's 1996 plan, however, this option would not retire those submarines until after the turn of the century, both to encourage Russia's compliance with

START II and to retain the flexibility for the United States to remain at higher START I levels if Russia does not.

Relative to the 1995 plan, canceling D5 missile production after 1996 could save $1.7 billion over the next five years. Savings relative to the 1996 plan would be about $700 million higher because that plan calls for spending more on missiles over the next five years and starting the backfit of one C4 submarine in 2000. This option would create significant savings beyond 2000 relative to either plan because it would operate fewer submarines and avoid the cost of modifying C4 submarines and purchasing D5 missiles.

Several drawbacks are associated with terminating production of D5 missiles. Increasing the number of warheads per missile from five to seven would reduce the range of the missiles by roughly 20 percent. That would limit the areas of the ocean in which submarines could operate, thereby making the fleet more vulnerable. Furthermore, it would reduce the targeting flexibility of the force because missiles with fewer warheads can cover more widely dispersed targets. Also, requiring the Navy to deploy D5 missiles with seven warheads would constrain the United States' ability to increase sharply the size of its SLBM force by adding back the extra warheads if Russia broke out of START II, a central concern of some critics of this option. (See Congressional Budget Office, *Rethinking the Trident Force*, July 1993, for more details about the effects of this and other options for reducing the costs of the Trident force.) In addition, reducing the force from 14 to 10 submarines may increase its vulnerability to attack by Russia's antisubmarine forces. Critics also worry that terminating the production of the D5 missile early would leave the United States unable to produce new SLBMs without an expensive rebuilding program.

Nevertheless, terminating D5 production may be acceptable given the marked reduction in the chances of nuclear war between the superpowers. In that environment, the capability retained under this option for Trident submarines to destroy hardened targets, which exceeds the capability of today's fleet of ballistic missile submarines, may be judged sufficient to deter nuclear war. Although the range of the missiles and the size of submarine patrol areas would be smaller under this option than under the Administration's 1995 or 1996 plan, they would still exceed those planned during the Cold War when Russia's antisubmarine capability was greater and the United States intended to deploy the D5 with eight large warheads (W-88s).

The targeting flexibility given up by this option might not significantly reduce the ability of the SLBM force to deter nuclear war. It is not clear that the force of 1,680 warheads that the Administration plans to deploy on its Trident fleet under START II will deter an adversary more effectively if they are deployed on 336 missiles rather than on the 240 called for in this option. The diminished likelihood of nuclear war with Russia may also have weakened the rationale for the United States to deploy only five warheads on each D5 missile in order to retain its ability to increase U.S. nuclear forces rapidly. Moreover, the United States could increase the number of warheads on land-based ballistic missiles and bombers if Russia violated START II. Finally, supporters of this option would argue that the aerospace companies involved in refurbishing the Minuteman III and building boosters for space launchers will maintain enough skilled workers so that production of a new SLBM could be started in time to replace the missiles lost as Trident submarines begin to retire during the next century.

DEF-03 REDUCE THE SCOPE OF DOE'S STOCKPILE STEWARDSHIP PROGRAM

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	55	122	220	247	276	920
Outlays	28	80	161	219	258	745

For the first four decades of the nuclear age, the United States developed, tested, and produced nuclear weapons for its arsenal. The Department of Energy (DOE) and its predecessors have been responsible for that task. During much of the Cold War, the arsenal held over 25,000 warheads of more than a dozen different types. The weapons were designed and developed at the three weapons laboratories (Los Alamos, Lawrence Livermore, and Sandia) and tested at the Nevada Test Site; materials and components for the weapons were produced at more than a dozen facilities across the country.

The end of the Cold War has changed the requirements for the arsenal. In response to the second Strategic Arms Reduction Treaty (START II), the United States plans to keep roughly 5,000 warheads of 10 different types in its active inventory beyond 2003. DOE has started to consolidate its production facilities as it adjusts to its declining workload.

The United States, along with all other nuclear powers except China, has also unilaterally halted all underground testing. To establish a permanent worldwide moratorium, it has been negotiating a comprehensive test ban (CTB) treaty that will make it difficult for any country to develop new weapons. The Administration would like the treaty to be completed as soon as possible.

To preserve its ability to ensure, over the long run, the reliability and safety of the weapons that remain in the nuclear stockpile under a CTB, the Department of Energy has developed a stockpile stewardship program. One goal of that program is to increase funding for activities such as computer simulations, hydrodynamic testing, and fusion research that will become increasingly important in the absence of underground testing. Another goal of the plan is to ensure that the weapons labs continue to attract talented scientists by providing challenging work and state-of-the-art facilities.

To carry out this plan, DOE will continue to operate both of its weapons design labs (Los Alamos and Lawrence Livermore) and its engineering lab (Sandia). It will also construct several new facilities --including the Dual-Axis Radiographic Hydrotest (DARHT) facility at Los Alamos for hydrodynamic tests and the National Ignition Facility (NIF) at Lawrence Livermore for research on the fusion portions of the weapons--to provide data on the reliability and safety of weapons as they age. In addition, DOE plans to keep the Nevada Test Site operational so that it can conduct hydronuclear experiments (hydrodynamic tests in which a very small nuclear explosion--equivalent to a few pounds of TNT--actually occurs). The laboratories also plan to spend some $220 million annually for cooperative research and development agreements (CRADAs) and other technology transfer initiatives in which laboratory scientists work with industry to share technology with the private sector.

Under the stewardship program, DOE would spend $1.6 billion annually for weapons research, development, and testing (RD&T), or about $350 million less than it spent in 1993. However, the annual expenditures for RD&T under the Administration's plan, after adjusting for inflation, would still be about the same as in 1980 when the United States was both designing new warheads and maintaining an arsenal of some 25,000 warheads. Further reductions in spending may therefore be possible.

This option would reduce the scope of the stewardship program by consolidating the two design laboratories, forgoing all hydronuclear testing activities at the Nevada Test Site, and trimming funding for CRADAs by one-third. To offset the effect of those cuts, this option would gradually increase funding for other stewardship activities until it reached $60 million a year in 1998. Taken together, those policy changes would save $55 million in 1996 and $276 million annually by 2000 compared with the Administration's 1995 plan. From 1996 through 2000, this option would save a total of $920 million.

For illustrative purposes, the above savings assume that weapons activities would be consolidated at Los Alamos over a period of five years; Lawrence Livermore would no longer have the designing of nuclear weapons as its primary focus. Los Alamos designed eight of the 10 types of nuclear weapons that are likely to remain in the stockpile. To ensure that the two other warhead types could be reliably maintained, some designers from Livermore would have to move to Los Alamos. This option would maintain a cadre of weapons scientists at Livermore to provide peer review for Los Alamos's efforts. To ensure that those scientists have challenging work, Livermore would retain substantial computational facilities for modeling the complex processes inside nuclear weapons and would proceed with DOE's plans to build the National Ignition Facility. (The savings would be lower if stewardship activities were consolidated at Lawrence Livermore because that would involve moving more facilities and relocating more weapons designers. Also, the environmental issues raised by introducing new nuclear facilities into the populous area surrounding Livermore could prove difficult to overcome.)

By forgoing hydronuclear tests, DOE could shut down all testing operations at the Nevada Test Site and save $140 million annually by 2000. The purpose of hydronuclear experiments is to test the nuclear reactions in the plutonium pit in the presence of neutrons from a warhead's neutron generator. Those tests are controversial because they involve an actual, albeit very small, nuclear explosion and for safety reasons are conducted underground. Some of the countries negotiating the CTB and some groups within the United States oppose such experiments because they could allow established nuclear powers to continue to design and test new weapons. Thus, critics argue that hydronuclear experiments run counter to the spirit of both the test ban and the Nuclear Non-Proliferation Treaty, which commits the nuclear powers to work toward disarmament. The tests are also contentious because they carry a remote risk of a larger nuclear explosion if they are not conducted properly, although such an explosion would be contained underground.

Finally, by trimming funding for CRADAs by one-third, this option would reduce the amount of money flowing into the laboratories for technology transfer. Cuts would be phased in over two years so that the labs could honor existing contracts. The additional funding for basic stewardship under this option would enable laboratory scientists to refocus their efforts on weapons activities.

The central question underlying this option is, What is required to ensure the reliability and safety of the stockpile in the future if the current moratorium on underground nuclear testing is made permanent? DOE's stewardship program is the Administration's answer, although the laboratories feel they need at least an additional $60 million annually to support basic stewardship. This option preserves much of what the stewardship plan calls for, including DARHT and NIF, but does not support hydronuclear testing or fund two full design labs.

Some people may feel that this option cuts the program too deeply. They believe that DOE's stewardship program is the minimum effort necessary to maintain the stockpile without underground testing. Cuts would not be prudent, they argue, because scientists will need new facilities to obtain data on reliability that was formerly provided directly by underground nuclear testing. Supporters of DOE's stewardship program also object to the consolidation proposed here. In their view, two design laboratories are essential for providing a robust stewardship program: competition and peer review would continue to be important, even in the absence of underground testing. Furthermore, refocusing the efforts of one lab away from weapons research would eliminate its central unifying mission (and thus its motivation for excellence) without replacing that focus with an equally important mission. Consolidation would also result in the loss of some facilities that could not easily be

transferred to the other lab. Advocates of the stewardship program also disagree with this option's proposal to forgo hydronuclear experiments, because it would surrender a diagnostic tool that, in their view, would be very important in measuring how age affects the complex interactions within the plutonium pit during the early stages of detonation.

Some critics argue that the stewardship program should be cut further than suggested in this option. Some believe that keeping part of a second lab, increasing money for basic stewardship, and building DARHT and the $1.1 billion National Ignition Facility are unnecessary to support the stockpile. In their view, those facilities may allow DOE scientists to continue designing and testing weapons and to circumvent a test ban treaty. Even if DOE has no intention of designing new weapons, they argue, the perception of such a capability may make it difficult to convince nonnuclear countries--from whom the United States would like continuing support for the Nuclear Non-Proliferation Treaty--that the United States has really given up testing. Critics also contend that the nation cannot afford to keep a portion of a second design lab or NIF; they argue that if NIF can help scientists to understand how to harness fusion for civilian energy, as supporters claim, it should be funded outside the nuclear weapons program.

DEF-04 FOCUS THEATER MISSILE DEFENSE EFFORTS ON CORE SYSTEMS

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	300	300	500	600	880	2,580
Outlays	130	250	370	500	620	1,870

The Strategic Defense Initiative, which President Reagan started in 1983, focused solely on protecting the United States from a deliberate large-scale attack by Soviet ballistic missiles. The Bush Administration added an effort to protect U.S. troops and allies' civilian populations from attack by shorter-range "theater" missiles such as the Scuds used in the Persian Gulf War. The Clinton Administration--citing the urgency of the threat posed by theater ballistic missiles and the end of the Cold War--has reoriented the program to give priority to developing theater missile defenses (TMDs). It has also de-emphasized the effort to develop so-called national missile defenses, delaying indefinitely a decision to deploy defenses to protect the United States against longer-range missiles. To reflect those changes, it has renamed that effort the Ballistic Missile Defense (BMD) program. This option would make cuts in theater missile defenses beyond those proposed by the Administration.

According to its plan for 1995, the Administration will spend about $19 billion for all BMD efforts from 1996 through 2000--an average of roughly $3.8 billion a year. Of that, an average of $2.6 billion will be spent on TMD each year: $2.3 billion by the Ballistic Missile Defense Organization, and almost $200 million by the Air Force and the Army on programs that are funded outside the organization's budget.

Under its restructured TMD program, the Administration would deploy a core package that includes both point defenses (which can protect relatively small targets like airfields or command facilities) and area defenses (to protect areas a few hundred kilometers in diameter). Specifically, the Army would deploy a point defense called the Patriot Advanced Capability 3 (PAC-3) and an area defense called Theater High-Altitude Area Defense (THAAD). The Navy would develop a sea-based point defense using the Standard missile that the Navy deploys on its Aegis destroyers and cruisers.

In addition to the core systems, the Administration plans to continue developing three advanced-capability theater defenses: a Navy sea-based area defense; a mobile Army point defense called the Corps Surface-to-Air Missile (Corps SAM); and an Air Force boost-phase interceptor that would destroy missiles early in their flight. All three will be funded at a modest level through 1999. Because of budget constraints, however, the Ballistic Missile Defense Organization expects to deploy only one of those systems. The extent to which it develops the other two after 1998 will depend on future budget conditions.

To increase the area that THAAD and the Navy's area defense can protect, the Administration is developing space-based sensors, a constellation of satellites called Brilliant Eyes. The Administration would also develop a battle management system to enable these TMD systems to function effectively together. Finally, the Administration plans to continue paying for much of Israel's effort to develop the Arrow missile as an area defense system.

Some Members of Congress have expressed concern about the cost of developing so many apparently redundant systems, including both land- and sea-based point and area defenses. Some Members also question why the United States should bear all of the cost to develop area defenses like THAAD that would be used primarily to protect the civilian populations of other nations. Other critics are concerned

that the Brilliant Eyes space-based sensor proposed by the Administration would violate the terms of the Anti-Ballistic Missile (ABM) Treaty.

This option would save money by developing only the core TMD programs: Patriot PAC-3, the Navy point defense, THAAD, and a battle management system. The three advanced-capability systems and the Brilliant Eyes program would be terminated, as would Air Force funding for boost-phase interceptors (roughly $100 million a year). This option would keep all non-TMD funding at the Administration's planned level but would eliminate funding for Israel's Arrow missile.

Relative to the Administration's 1995 plan, these actions would save $300 million in 1996 and nearly $2.6 billion over the next five years. Savings relative to the Administration's plan for 1996 and beyond would be nearly the same because the Administration has not changed its plan significantly.

By canceling the Navy's area defense system, this option would reduce the flexibility of U.S. commanders during a crisis. Although sea-based defenses are limited to defending coastal regions, they can be deployed to a region quickly and do not require access to secure airfields to be airlifted into the theater--a limitation of land-based systems like THAAD. The United States can also deploy sea-based defenses without having to obtain basing rights in another country, a process that could cause domestic political difficulties for some friendly governments. This option would preserve the capability to defend small areas such as ports or amphibious landings from the sea. But without the Navy's sea-based area defense system, the United States would not be able to defend larger areas such as cities until THAAD could be deployed. Nor could it use forward-based ships to defend large areas of Europe or Japan against attack from the Middle East or North Korea, respectively.

Changes under this option would also limit the area that could be defended by the remaining systems. Canceling Brilliant Eyes would limit the area that THAAD could defend because ground-based sensors would take longer to detect and track incoming missiles, thereby reducing the range at which those missiles could be intercepted. Canceling Brilliant Eyes could also affect the capability of a future national missile defense system, if the United States eventually chooses to deploy one. In addition, terminating boost-phase interceptor programs would halt work on systems that have the potential to be effective against missiles armed with nuclear or chemical warheads if technical problems can be overcome. Finally, cutting off funding for Israel's Arrow area defense missile would jeopardize a critical program for one of the United States' closest allies, which currently faces a real threat from ballistic missiles.

Notwithstanding those disadvantages, under this option the United States would still deploy capable land- and sea-based point defenses, a land-based area defense, and a battle management system, all according to the schedule proposed by the Administration. By eliminating all TMD funding beyond the core systems, this option would halt several programs early in their development phase. In addition to the savings between 1996 and 2000, those actions could save significant sums beyond 2000, when the advanced TMD systems and Brilliant Eyes would have entered full-scale development and production. (At current and projected budget levels, procurement funds may never be available for many of these systems.) This option would also eliminate payments to Israel to support development of the Arrow missile. In this period of tight budgets, it may be inappropriate to spend U.S. funds to develop a foreign system that the United States has no intention of buying.

In addition to lowering costs, canceling Brilliant Eyes would eliminate the concerns of some critics that the sensors--by effectively substituting for ABM radars--would significantly increase the area that THAAD could defend and thus would violate the ABM treaty. The contractor building THAAD has stated that the system's capability does not depend critically on Brilliant Eyes and that such sensors are needed only to defend the large areas required for national missile defenses. Since the Administration has delayed indefinitely a decision to deploy national missile defenses, space-based sensors such as Brilliant Eyes may not be required for many years, if at all.

DEF-05 REDUCE THE NUMBER OF AIRCRAFT CARRIERS AND AIR WINGS TO 10

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	460	960	1,000	1,030	1,070	4,520[a]
Outlays	330	760	900	970	1,030	3,990

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

a. Estimated savings include a notional air wing that is based on the Navy's estimates of size and composition.

The aircraft carrier is the centerpiece of the U.S. Navy. The Administration's 1995 plan calls for a fleet of 12 carriers in 2000 (11 active plus one carrier, manned partly by reserves, that could also be used for training) with 10 active air wings and one in the reserves to provide combat capability for those ships. The carriers would be accompanied by a mix of surface combat ships--usually cruisers and destroyers--and submarines that can attack planes, ships, and submarines that threaten the carrier. These surface combatants and submarines can also attack targets on land.

Some policymakers have argued that the United States does not need a force of 12 carriers in the aftermath of the Cold War. The total capability of all U.S. tactical aircraft in the Navy and Air Force would substantially exceed that of any regional power that seems potentially hostile. Cuts may therefore be acceptable.

Moreover, the capabilities of U.S. ships are unsurpassed worldwide. The Navy has ships other than carriers, including large flat-deck amphibious vessels, that can assist in maintaining a U.S. naval presence overseas in peacetime. Perhaps for these reasons, some policymakers have contemplated carrier force levels below those recommended by the Administration's plan. In 1990, before the breakup of the Soviet Union, the Chairman of the Senate Committee on Armed Services recommended a force of 10 to 12 carriers. And during the 1992 campaign, President Clinton called for a Navy with 10 carriers.

This alternative would retire two conventionally powered carriers early so that by 2000 the Navy would have 10 carriers (nine active carriers and one manned partly by reserves that could also be used for training). In addition, from the force of 10 active and one reserve air wings, it would eliminate one active air wing and leave nine active air wings and one reserve wing to match the number of carriers.

Compared with the 1995 plan, which has 12 carriers and 11 air wings, savings could total about $460 million in 1996 and roughly $4.5 billion over five years. (The Administration's 1996 budget does not materially change its 1995 plan.) Costs to decommission the retiring ships would offset some of the savings, but CBO does not have the data to estimate their magnitude. The Navy might realize procurement savings, also not included in the savings shown above. For example, the Navy might not need to buy as many DDG-51 destroyers for the smaller number of carrier battle groups (see DEF-08 for a discussion of the DDG-51). Also, the cut in air wings would reduce the number of required aircraft (see DEF-09 for a discussion of changes in procurement of naval aircraft).

According to former Secretary of Defense Les Aspin, reducing the force to 10 carriers would not impair the ability of the U.S. military to fight and win two regional wars that start nearly simultaneously. He has argued, however, that having fewer ships would limit the Navy's ability to keep three carriers deployed overseas most of the time. In peacetime,

some carriers spend time in repair; others are kept at U.S. ports to provide stateside duty time for their crews; still others are in transit to their operating stations. The Navy argues that only one-quarter or less of the carrier fleet can be deployed overseas in peacetime. Thus, a reduction to a fleet of only 10 carriers might mean that, much of the time, one carrier fewer on average could be deployed overseas compared with the level under the Administration's 1995 plan.

It may be possible, however, to maintain deployments with a smaller fleet. The factors the Navy used throughout the 1980s implied that about a third of the carrier fleet would be deployed overseas. Moreover, the Navy kept five of its 13 carriers overseas in the late 1970s. Based on that experience, the fraction of the carrier fleet that might operate routinely overseas is larger than the Navy's current formula would suggest, although according to the Navy such intensive use of carriers led to a number of problems.

Furthermore, a reduced overseas presence may be acceptable in the post-Cold War world. The United States would still have at least two carriers deployed overseas at any one time, and possibly more if the Navy deployed a larger fraction of its carrier fleet. However, some missions, such as those requiring substantial numbers of fixed-wing aircraft, can be performed only by carriers. For example, carrier aircraft can be used to hit moving targets at longer ranges. In a crisis requiring such capability, a smaller force might mean an increase in the time before U.S. combat capability becomes available.

Alternatively, the Navy could use surface combatants other than the aircraft carriers to maintain a naval presence in peacetime and to assist in responding to crises. For example, it could use groups of ships centered around as many as 12 large flat-deck amphibious assault ships (smaller carriers) that are designed to transport the Marines and their equipment; those ships can embark helicopters and Harriers (Marine Corps attack aircraft that can land and take off vertically) and are as large as the aircraft carriers of many other countries. These Amphibious Ready Groups are fully capable of handling some missions usually performed by carriers, such as conducting limited strikes and evacuating noncombat personnel.

The Navy may also be able to meet some of its deployment requirements with groups of surface combatants that do not include any kind of carrier. Those formations have been made possible because the offensive capabilities of surface combatants have been augmented with the Tomahawk missile for attacking targets hundreds of miles inland and because their defensive capabilities have been enhanced by the Aegis system for defense against attacks from aircraft and antiship missiles. With the demise of the Soviet Union, a substantially reduced threat to U.S. ships also contributes to the feasibility of maintaining a presence with ships other than carriers. The Navy has already used formations without aircraft carriers to provide overseas presence. None of the formations, however, is as capable as a carrier battle group.

However, if policymakers continue to use aircraft carriers for overseas presence at current levels but the Navy has fewer vessels available, the time that ships spend at sea would have to increase. That would mean that the high-quality sailors the Navy needs would be spending more time away from their homes and families, thus making it harder for the Navy to retain them.

DEF-06 CANCEL PROCUREMENT OF THE THIRD SEAWOLF SUBMARINE

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	1,260	0	0	-240[a]	0	1,020
Outlays	-140[b]	340	360	160	60	780

a. Net cost to reconstitute a shipyard in 1999.

b. Outlays incurred in shutting down a shipyard completely offset savings in 1996.

The Seawolf submarine was designed to counter projected improvements in Soviet submarines. Like the SSN-688 (Los Angeles class) submarine that it follows, the Seawolf's mission is to detect and destroy enemy submarines and surface ships and to launch cruise missiles against targets on land. According to the Navy, the Seawolf would have many advantages over the SSN-688, including the ability to dive deeper, carry more weapons, and operate more quietly at higher speeds. In addition, it would have advanced sensors for detecting enemy submarines and a more powerful computer system to coordinate sensors and weapons.

In 1992, a combination of budgetary pressures and the end of the Cold War led the Bush Administration to propose canceling the Seawolf program after buying the first vessel. The Congress, however, decided to fund a second submarine, and the Clinton Administration subsequently expressed its support for producing a third Seawolf (designated the SSN-23).

In the Bottom-Up Review, the Administration justified buying the SSN-23 to help preserve the submarine industrial base. The submarine will be purchased to keep open two shipyards capable of producing nuclear-powered submarines. Officials from the Navy argue that keeping both yards with those capabilities ensures the excess capacity needed to produce large quantities of submarines if the threat increases rapidly or for backup production if a catastrophe, such as a fire, befalls one shipyard.

Because the Navy now needs fewer submarines to meet the reduced threat posed by submarines of the former Soviet Union, a seven-year gap in production will exist between authorization of the second Seawolf (1991) and the scheduled authorization date for the Seawolf's successor--the New Attack Submarine (1998). Without new orders for submarines during the 1996-2000 period, General Dynamics' Electric Boat shipyard--one of the two U.S. facilities that produce nuclear-powered submarines--will probably cease production. Department of Defense officials have therefore decided to design and build the third Seawolf at that yard. The survival of Tenneco's Newport News Shipbuilding is not put in jeopardy because it produces aircraft carriers and commercial vessels as well as submarines.

This option would cancel plans to buy the third Seawolf. It could save as much as $1 billion during the 1996-2000 period compared with the Administration's 1995 plan, with most of the savings occurring in 1996.

The Navy expects the SSN-23 to cost about $2.5 billion, and the Congress has already appropriated about $920 million that could be used to purchase the ship. Of the $920 million, about $380 million was appropriated for advance procurement of the ship's combat system and components of the nuclear reactor; the remaining $540 million was appropriated to support the submarine industrial base and to help pay for a third Seawolf. CBO estimates, based on a study for the Department of Defense by RAND, that if the

third Seawolf is not produced, the Navy will incur about $520 million in additional expenses to close down submarine production and restart it to produce the first New Attack Submarine (designated the NSSN) in 1998. The estimated $2.5 billion cost for the third Seawolf minus the $920 million already appropriated and the added costs of approximately $520 million to close down and restart facilities leaves about $1 billion in savings. Because of the great uncertainty in estimating the costs of reconstitution, however, costs could be higher, according to the Office of the Secretary of Defense and Navy officials.

If the SSN-23 was canceled, submarine production could be reconstituted in the future at either Newport News or Electric Boat. The longer the production of the NSSN is delayed, producing it at Newport News becomes a lower-cost alternative than doing so at Electric Boat. Some analysts believe that such a delay is possible because exploring and defining the concept for the basic design of the ship took a year longer than planned. The Navy, however, maintains that construction can still begin in 1998. As production of aircraft carriers progresses at Newport News, workers could begin to transfer from work on the CVN-76 nuclear-powered aircraft carrier to submarines. Moreover, in the longer term, consolidating submarine production at Newport News--the country's largest private shipyard--would probably lower costs significantly by allowing the work force to alternate between carrier and submarine production as needed and by reducing excess naval shipbuilding capacity. In the near term, however, there might be some costs in money and time to amend the design of the NSSN--which is being designed to be produced at Electric Boat--so that it could be produced at Newport News.

In addition to reducing the costs and risks of reconstitution by employing the carrier workforce at Newport News, the Navy might further mitigate these effects by moving some submarine overhauls and modernizations from public shipyards to Newport News. Newport News Shipbuilding already has the facilities to produce, overhaul, and refuel both nuclear-powered carriers and submarines (although some costs might be incurred to restart the dormant facility to refuel submarines). The principal cost of reconstituting the submarine industrial base is that for locating, rehiring, and retraining the workforce. According to the RAND study, the production and overhaul of carriers and the overhaul of submarines would exercise the vast majority of skills required to sustain the industrial base for submarine production, thus significantly reducing the cost and time to reconstitute that capability in the future. Also, overhauling the Navy submarine force could generate more employment than building the SSN-23. France, which produces nuclear-powered submarines at a low rate and experiences large gaps in production between new classes of boats, relies on the construction and overhaul of other ships and the overhaul and modernization of submarines to maintain its submarine production base.

Proponents of the SSN-23 contend that once reconstitution costs are factored in, the savings from canceling the boat are not certain enough to outweigh the risks associated with a plan to reconstitute a shipyard. Proponents also contend that the SSN-23 would maintain the industrial base of submarine subcontractors until the NSSN is built. Buying the SSN-23, however, would not greatly affect maintenance of the industrial base for components used in nuclear propulsion, because most of the funds for the submarine's reactor have already been appropriated for advance procurement. In fact, funding the CVN-76 carrier in 1995 was more crucial to maintaining the base of subcontractors for nuclear components of submarines than buying the SSN-23 would be.

In addition, according to the study by RAND, most suppliers of nonnuclear components could begin producing them again fairly easily after any gap in production. The study noted that the Navy could help keep the other suppliers in business by funding items before they were needed, paying the suppliers to develop a prototype method for manufacturing the items, allocating other Navy work to the firms, or using them to revitalize, modernize, or replace equipment on existing submarines. According to a report by the General Accounting Office, if key subcontractors went out of business, the cost and time to reconstitute production of components could be reduced by having government laboratories or the shipbuilder take over production, as Newport News did with torpedo tubes. Also, the Navy might sign agreements with other nations that produce nuclear-powered submarines--for example, France and the United Kingdom--to buy components from each other.

DEF-07 ELIMINATE FRIGATES FROM THE NAVAL FORCE

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	80	240	420	600	780	2,120
Outlays	60	190	340	520	690	1,800

NOTES: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The Administration has made significant changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

In addition to aircraft carriers, the primary surface combatants of the U.S. Navy are cruisers, destroyers, and frigates. Cruisers and destroyers often form part of a carrier battle group, escorting and protecting the carrier. Destroyers and frigates can escort the ships of an Amphibious Ready Group, which carries Marine troops and equipment. Frigates also can escort both the Underway Replenishment Groups that resupply naval forces and the convoys of merchant ships that resupply troops fighting in a foreign theater. Under the Administration's 1995 plan, the U.S. Navy projects that it will need 126 cruisers, destroyers, and frigates in its inventory in 1999--116 surface combatants in the active forces and 10 frigates in the reserve forces. Although that number of surface combatants constitutes a significant reduction from about 150 under the Bush Administration's proposed "base force," further reductions are possible.

The Navy's inventory for 1995 includes 49 Oliver Hazard Perry class frigates (FFG-7s). For the Navy to reach its goal of 126 surface combatants by 1999, its 1995 plan would have retired early 16 of the 49 frigates.

This option would reduce the number of surface combatants by retiring early the additional 33 FFG-7s, leaving 93 surface ships in the inventory by 2000. Twenty-three of those 33 FFG-7s would be retired from the active forces and 10 from the Naval Reserve forces. Reductions would be carried out in equal increments from 1996 through 2000. Compared with the 1995 plan, savings could total about $80 million in 1996 and roughly $2.1 billion over the next five years.

Because of a continuing high level of overseas commitments, the Navy recently decided to retain additional FFG-7s in the force instead of retiring them early. Compared with the Administration's plan for 1996 and beyond, which according to CBO estimates will keep 40 FFG-7s by 2000, savings could be $100 million in 1996 and about $2.7 billion over the 1996-2000 period.

Retiring the remaining Perry class frigates would remove this class of ships from the Navy's inventory. Retiring an entire class of ships can substantially reduce expenses for logistics and spare parts. Cutting the number of surface combatants might also permit a cut in the number of combat logistics ships and, hence, in their associated operating and support costs. Those potential savings, however, are not included in this option. Some of the savings in this option would be offset by costs to decommission the ships being retired, but those costs would probably be small.

The favorable security environment today might allow the Navy to reduce forces and invest the savings in new technology. With the dissolution of the Soviet Union, the threats facing Navy ships from enemy aircraft and submarines operating in the open ocean have greatly diminished. The most likely opponents the United States would face in a regional war generally have only modest naval assets and no heavy bombers that could attack U.S. ships at long

ranges. The United States may be able to counter those threats even while substantially reducing the number of surface combatants.

Moreover, the FFG-7 frigates, which specialize in antisubmarine warfare, are the Navy's smallest and least capable surface combatants. Because the submarines of the former Soviet Union have become less of a threat and war in Europe has become much less likely, the United States may no longer need frigates to escort merchant vessels. In addition, because submarines now pose less of a threat to Amphibious Ready Groups and Underway Replenishment Groups in transit to carrier battle groups, fewer surface combatants may be needed as escorts.

Current events, however, may argue against reducing the surface fleet. Under this option, the Navy would have fewer surface combatants to deploy for independent operations not involving carrier battle groups. For example, the Navy has used frigates to conduct naval quarantines, such as that imposed on Haiti. If U.S. naval commitments remain high, operating less complex and lower-cost ships such as frigates might be required to give the Navy the numbers of ships needed to fulfill such missions. Because of its heavy load of current commitments, the Navy's 1996 plan will retain a force of more than 126 surface ships.

DEF-08 REDUCE PROCUREMENT OF DDG-51 DESTROYERS

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	940	950	970	1,010	1,050	4,920
Outlays	50	290	510	730	810	2,390

NOTE: The Administration has made significant changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

The DDG-51 destroyers of the Arleigh Burke class would be used in a war to protect aircraft carrier battle groups and to attack land- and sea-based targets. The ships incorporate the Aegis combat system for air defense. Compared with previous classes of destroyers, the DDG-51s incorporate other improvements in speed, weapons, and armor. The Navy states that the DDG-51s also will be more difficult for enemy forces to detect because of design features that reduce their radar, sonar, and infrared signatures.

To date, the Congress has funded 32 of the DDG-51s. The Administration's 1995 plan would buy 15 more DDG-51s--three per year from 1996 through 2000--at a total cost of about $14.8 billion. This option would buy only 10 DDG-51s from 1996 through 2000 at a rate of two a year. Compared with the 1995 plan, this option could save about $940 million in 1996 and $4.9 billion over the next five years. Compared with CBO's estimate of the Administration's 1996 plan, which would buy 13 DDG-51s over the next five years, savings would total about $3 billion through 2000. The smaller fleet of DDG-51s in the next decade would also result in savings in operating and support costs that are not included in this option.

Reducing the number of DDG-51s purchased per year could have some disadvantages. Buying fewer DDG-51s might reduce the capabilities of the fleet by providing fewer ships that can perform multiple missions (such as strike and antiair, antisurface, and antisubmarine warfare). With the Navy's post-Cold War policy of deploying its ships more flexibly, which could require that surface combatants sometimes be deployed without an aircraft carrier, such capabilities might be more important.

Moreover, proponents of the Administration's plan might contend that the advanced capabilities of the DDG-51s will continue to be needed in the post-Cold War world. The sophisticated combat systems that the DDG-51 incorporates include the Aegis system, which is designed to stop attacks by large numbers of enemy aircraft and their antiship missiles attempting to saturate the air defenses of the aircraft carrier battle group. The hostile air threat to the U.S. Navy has declined with the breakup of the Soviet Union, and smaller air forces of regional powers that the United States is most likely to fight are less capable of launching saturation attacks. Combat against regional powers, however, is likely to bring ships into littoral areas where they would have less time to react to threats and thus might benefit from the quicker reaction of the Aegis system. Nevertheless, some analysts believe that the DDG-51, which was designed during the Cold War, is not optimally designed to fight in coastal areas and is too expensive to purchase in large numbers if the Navy's budget declines.

Only two shipyards currently build surface combatants, and reducing procurement to two vessels a year might sustain only one producer. The Congress would have to weigh carefully the possible effects of reductions to the country's naval shipbuilding capa-

bilities and the ability to reconstitute them if a change in threat required a buildup of forces.

In addition, savings from reducing purchases could be smaller than estimated under this option if the unit cost per ship rose because overhead was spread over fewer units produced. If reduced purchases caused one shipyard to close, the remaining shipyard might be able to charge higher prices that might offset some or all of the savings from lower production. In addition, if the remaining shipyard had to finish building ships that the closing shipyard had begun, the unit costs of those ships might rise. The government, however, might be able to arrange for the closing shipyard to finish ships under construction before going out of business.

The Navy may be able to minimize such growth in unit costs. Even if only one shipyard remained, the government--a single buyer that has many alternative uses for its limited procurement budget--might be able to exert pressure on that yard to restrain costs. Indeed, one approach that the Navy might take would be to let the two shipyards bid competitively for a single contract covering all 10 ships purchased during the 1996-2000 period. The size of such a contract would guarantee competitive bidding. In the longer term, closing a shipyard might reduce the Navy's costs by eliminating excess naval shipbuilding capacity.

A reduction in the number of DDG-51s, as proposed in this option, need not limit the Navy's ability to counter regional threats. For example, the combination and automation of sensor inputs and weapons in non-Aegis ships may allow them to react faster to the shorter-range threats in regional conflicts. Advances in communications may allow a ship with an advanced Aegis system to control the weapons of all other ships in a group, shortening the reaction time of the entire group.

Considering the reduced threat, the Navy may already have enough sophisticated Aegis ships. With the 69 Aegis ships that would eventually be available under this option (27 authorized CG-47 Ticonderoga class cruisers, 32 authorized DDG-51s, and 10 future DDG-51s), two could be assigned as escorts to each of the 12 aircraft carrier battle groups, leaving 45 available for independent operations. In addition, the Navy would need fewer Aegis ships to escort carrier battle groups if the number of carriers was reduced (see DEF-05) or if lower threat levels warranted assigning only one Aegis ship per battle group. Because of the reduced threat, the Navy is lowering the number of surface combatants assigned to escort and protect the aircraft carrier.

Even with the slower rate of construction in this option, the Navy might still meet its goal for surface combat ships. Under the Administration's 1995 plan, the Navy will seek to maintain a smaller force of about 120 to 126 active and reserve surface combatants (cruisers, destroyers, and frigates). If ships last as long as originally advertised, the Navy could cut its purchases of DDG-51s by five during the 1996-2000 period and still remain well above the goal of 120 to 126 ships by 2010. If the Navy's more recent estimates of a shorter ship life prove correct, the force of surface warships could remain a few ships shy of the goal by that year. In the longer term, however, reducing purchases of DDG-51s to two per year would exacerbate the Navy's ability to retain enough ships to meet the force goal. Should the Navy reduce that goal, buying fewer DDG-51s might be consistent with that reduction.

DEF-09 CANCEL THE UPGRADE OF THE NAVY'S F/A-18 FIGHTER AND BUY THE CURRENT MODEL

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	1,040	2,240	2,190	2,260	2,280	10,010
Outlays	480	770	1,240	1,800	2,070	6,360

For the foreseeable future, the F/A-18 aircraft will account for the bulk of the Navy's fleet of carrier-based aircraft that perform fighter and attack missions. The F/A-18 attacks targets both in the air (the fighter mission) and at sea or on the ground (the attack mission). The current version of the F/A-18 is designated the C/D model.

In 1991, the Navy announced plans to develop a new E/F variant of the F/A-18. The E/F version features several modifications: a longer fuselage, a larger wing, and a more powerful engine than are now on the C/D version. Those changes should enable the E/F version to carry a larger load of weapons than the C/D version, or to carry the same load about 50 percent farther. Both attributes are important factors in determining the plane's capability in the attack role. The new engine should also enable the heavier E/F aircraft to retain the speed and maneuverability of the earlier version, important performance considerations in fighter combat.

Though more capable, the E/F version will also be more expensive than the C/D model--about 36 percent more by some estimates--and the Navy will have to pay about $1.6 billion from 1996 through 2000 to develop the plane. This option would cancel development and procurement of the new E/F model and instead would buy sufficient additional C/D aircraft to maintain the Administration's planned production rates. Compared with the 1995 plan, savings would total about $1 billion in 1996 and $10 billion over five years. (Savings from the 1996 plan would be roughly the same as those shown above.) Savings from canceling the upgrade might be even larger if the F/A-18 experiences unanticipated cost increases.

The requirement for an upgraded F/A-18 aircraft may be questionable in view of today's reduced military threat. The threat to carrier battle groups stemmed largely from the former Soviet Union, and the possibility of conflict with the former Soviet republics now seems increasingly remote. Regional powers are not likely to be able to match the capability of current U.S. fighters for many years. But if the enhanced fighter capabilities offered by the E/F version are not needed, neither may be its added attack capabilities, based on the Navy's judgments about other systems. The Navy plans to retire its venerable but longer-range A-6 fleet in 1997 and has canceled development of a new longer-range replacement, the A/FX, at least in part because the service now places less emphasis on the deep strike mission and more on supporting Marine forces that operate at relatively short ranges from the ships that transport and support them. And even if the added capabilities of the E/F model are needed, trends in the F/A-18 program suggest that they may be hard to achieve. Some critics of the program have noted that the A/B model of the F/A-18 attained only about 75 percent of the originally specified goal for the fighter's range, and the C/D model achieved only about 70 percent of the original specification.

Canceling the E/F development program would have some disadvantages. Even in conflicts with smaller nations, improvements in the F/A-18's range, if they materialize, might be useful in the attack mission; indeed, critics of the C/D version believe its relatively short range limits its usefulness. Moreover, now that the A/FX has been canceled, the E/F upgrade will be the only major upgrade the Navy will purchase for its fighter fleet for at least 10 years.

DEF-10 CANCEL THE MARINE CORPS'S V-22 AIRCRAFT PROGRAM AND BUY CH-53E HELICOPTERS

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	570	1,120	1,070	1,030	810[a]	4,600
Outlays	360	580	710	800	780[a]	3,230

NOTE: The Administration has made changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

a. The 1995 plan did not include an estimate for funds for the V-22 program beyond 1999, although procurement would not be completed by then. CBO assumed that DoD would need to spend about $1 billion in 2000 to support planned procurement.

The V-22, a new plane entering production in 1997, is intended to help the Marine Corps perform its amphibious assault mission of seizing a beachhead in hostile territory and its subsequent operations ashore. V-22s will transport up to 24 marines or 10,000 pounds of their equipment, moving either from amphibious ships to the shore or from one shore base to another. The plane employs a "tilt-rotor" technology that enables it to take off and land vertically like a helicopter and, by tilting its rotor assemblies into a horizontal position, become a propeller-driven airplane when in forward flight. The V-22 will be able to fly faster than conventional helicopters; it will also fly longer distances without refueling and thus can "self-deploy" rather than being carried to distant theaters on planes or ships, the common mode of transport for conventional helicopters. The Marine Corps argues that analysis indicates that the V-22's increased speed and other characteristics of its design will make it less vulnerable when flying over enemy terrain.

Despite all of these advantages, the Bush Administration tried to cancel the plane, largely because of its expense. At a projected unit cost of more than $50 million (in 1994 dollars), the V-22 costs considerably more than most conventional helicopters. The V-22's flyaway cost, a price that excludes some items bought with procurement funds, averages about $40 million (also in 1994 dollars)--$5 million less than last year's estimate. The decrease in price is largely due to a reduction in the plane's expected weight, according to Marine Corps personnel.

Notwithstanding the V-22's high cost, the Congress has continued to fund it, and the Clinton Administration's 1996 budget request contains funds to continue development and begin procurement. The Marine Corps plans to procure a total of 425 V-22s. Another 50 planes might eventually be bought for special operations forces, and the Navy plans to buy 48 for combat search-and-rescue missions and for logistics support of its fleet.

At present, the Marines use helicopters to transport personnel and equipment in amphibious missions. One helicopter--the CH-53E, which carries heavier loads than the V-22 and costs about 50 percent as much to procure--will continue to transport Marine equipment even after the V-22 is fielded. The Marines will continue to need some CH-53Es to meet requirements for lifting heavier equipment, but the Administration bought the last of these helicopters in 1994.

This option would cancel the V-22 and continue procurement of CH-53Es. It would buy six CH-53Es per year from 1996 through 2000, half the number bought in 1994. Relative to the Administration's 1995 plan, the option would have saved about $570 million in 1996 and $4.6 billion over five years. Savings from the 1996 plan would be slightly less--$4.2 billion over five years. In addition to saving money, buying CH-53Es might entail less risk than developing a V-22. Two of five V-22 prototypes have crashed, as has one of two XV-15 aircraft built to demonstrate tilt-rotor technology. The Marine Corps

argues that the problems that caused those crashes have already been remedied without substantial design changes. But the crashes may suggest problems with the design. If there are problems, developers may need to increase the already high costs of the plane or reduce its capability.

The Marines Corps argues that the CH-53E does not meet its requirements for the amphibious assault mission for a number of reasons. First, the slower CH-53E is less likely than the V-22 to survive in hostile environments. Second, even if the V-22 is purchased, CH-53Es will be needed to transport heavy items of equipment that the V-22 cannot carry, but Marine Corps doctrine dictates that the first assault wave be delivered by a more survivable aircraft than the CH-53E. Furthermore, Marine Corps personnel suggest that CH-53Es might not be able to build up sufficient forces fast enough to stop enemy troops who might arrive soon after operations begin. Smaller U.S. forces would increase the likelihood of a U.S. defeat or potentially increase the number of casualties. This problem of building up forces quickly might be at least partially overcome if each CH-53E carried more troops, but the Marine Corps argues that CH-53Es are too unwieldy and vulnerable to carry large troop loads.

Finally, Marine Corps personnel argue that the CH-53E, or indeed any other current helicopter, would be unacceptable because it cannot deploy overseas without substantial assistance and risk. Many current helicopters can make the relatively long trips over water required to deploy in the Pacific, but they must refuel in flight, requiring the assistance of tanker aircraft, and their slower speed increases the chance that pilot fatigue will result in missing a tanker rendezvous or cause other mishaps.

DEF-11 REDUCE AIR FORCE TACTICAL FORCES

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	220	450	470	490	510	2,140
Outlays	160	360	420	460	480	1,880

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The military forces proposed by the Administration include 20 tactical air wings--13 active and seven in the part-time reserves--six fewer than the Bush Administration planned to have. (Traditionally, an Air Force tactical air wing has consisted of 72 combat aircraft, plus about 28 aircraft for training and maintenance, though the service may be revising this concept.) Substantial disagreement exists about whether all of these forces are needed, since U.S. tactical aircraft enjoy overwhelming superiority compared with the forces of regional powers that appear potentially hostile to the United States. Perhaps for that reason, former Secretary of Defense Les Aspin, when he was the Chairman of the House Committee on Armed Services, recommended in 1992 that the Air Force retain only 18 tactical wings--10 active and eight reserve.

This alternative would follow that recommendation and further reduce the tactical fighter forces in the Air Force to 18 wings by the end of 1996. So rapid a schedule for reductions should be feasible inasmuch as the Air Force has reduced the size of its fleet quickly in the past; for example, it eliminated six wings during 1991 and 1992. Moreover, the six additional wings the Clinton Administration is eliminating will be cut by the end of 1995. Reducing the number of Air Force wings to 18 would cut the service's operating costs by $220 million in 1996 and by $2.1 billion through 2000 in comparison with CBO's estimate of the Administration's 1995 plan. (Savings compared with the Administration's 1996 plan would be similar.) Additional savings might accrue from reductions in the procurement of aircraft, but those savings are not included in the table above. (See DEF-12 for a discussion of changes in procurement of Air Force tactical aircraft.)

In addition to achieving savings, a reduction to 18 Air Force wings could still leave the United States with an acceptable level of military capability in a post-Cold War world. "Balance and Affordability of the Fighter and Attack Aircraft Fleets of the Department of Defense," an April 1992 CBO analysis of several potential adversaries (North Korea, postwar Iraq, and Cuba), found that even after reducing the number of tactical air wings to 26 as proposed by the Bush Administration, the capability of the tactical aircraft in the Air Force exceeded that of the other countries by factors of 22, 24, and 56, respectively. (The analysis was based on a scoring system developed for the Department of Defense.) The large margin of superiority suggests that additional reductions may be feasible without sacrificing the U.S. advantage.

Retaining only 18 wings in the Air Force, however, would not meet the military's current estimate of its requirements. Analysis by the Department of Defense suggests that 20 wings would be the minimum needed to win two nearly simultaneous regional conflicts. Today's U.S. force planning assumes that the United States needs to be able to fight virtually simultaneous wars in two regions of the world--one in the Middle East and another perhaps in Asia. If one accepts that requirement, then the Air Force may well need more than 18 wings.

Some analysts would also argue that additional cuts in Air Force wings ignore a major lesson from

the war with Iraq: aerial bombardment by tactical aircraft can be quite effective and may greatly accelerate the end of a war, thus reducing the loss of lives among U.S. ground troops. A sizable inventory of tactical aircraft, perhaps more than would be maintained under this option, may therefore be a wise investment.

DEF-12 CANCEL THE AIR FORCE'S F-22 AIRCRAFT PROGRAM

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	2,410	2,560	2,220	3,020	4,280	14,490
Outlays	1,080	1,720	1,640	1,770	2,210	8,420

NOTE: The Administration has made significant changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

The F-22 aircraft is being developed as the Air Force's next premier fighter and is scheduled to begin replacing the F-15 aircraft around 2000. Fighter aircraft are designed primarily to destroy enemy planes, thus guaranteeing the United States and its allies control of the air. The Air Force wants the F-22 aircraft to have supersonic cruise speed as well as stealth characteristics that make it difficult for enemy sensors to detect. The F-22 aircraft would also be designed to fly long distances and to have highly effective avionics that could make it more capable than other fighters in many types of combat. The F-22 entered full-scale development in 1991, and the first F-22s are to be bought in 1997, according to the Administration's 1995 plan. Changes revealed in the 1996 program suggest that the Administration now plans to defer purchase of the first fighters until 1998.

This option would cancel the F-22 program on the grounds that its additional capability may be both unnecessary and too expensive. Compared with the 1995 plan, canceling the F-22 would save about $2.4 billion in 1996 and nearly $14.5 billion for the 1996-2000 period. As a result of deferring the production of fighters, savings from the 1996 plan would be lower at $2.2 billion in 1996 and $11.5 billion over the 1996-2000 period. (The total estimated savings include procurement, research and development, and military construction.)

The high cost of the F-22 is one argument for canceling it. The Air Force planned to buy 648 aircraft in January 1993 at a total cost of about $74 billion in 1995 dollars ($86.6 billion in current dollars). The average unit procurement cost of the F-22 would have been about $84 million in 1995 dollars. Now the Air Force seems likely to buy no more than 442. Total program costs declined by only 19 percent (in 1995 dollars) even though the total quantity fell by nearly a third. The reduction in quantity, and other factors, pushed up the unit procurement cost of the F-22 to about $91 million (in 1995 dollars), about 8 percent more than the estimate provided in January 1993 and roughly 46 percent more than the average cost of the F-15E.

Since the costs of many weapon systems increase during the full-scale development phase that the F-22 entered in 1991, actual costs could rise even more. For example, the F-22's cost could rise if the Air Force has to fix design flaws. The Air Force argues that the April 1992 crash of the only flying prototype of the F-22 was caused by the way the aircraft was operated and that certain operating restrictions or, at most, minor software changes should prevent future problems, but such mishaps may portend costly production problems. Some recent press reports also suggest that the F-22 may be experiencing other development problems, such as increases in weight, that can raise its costs. And unit costs will rise if F-22 procurement is reduced even further below planned levels.

Events in the Persian Gulf suggest that current Air Force aircraft are able to counter any threat less severe than that formerly posed by the Soviet Union, which many analysts consider to have been the only hostile country whose air force had the capability to threaten U.S. fighters. In view of that reduced threat,

the F-22 may provide more capability to attack enemy fighters than the United States needs.

Moreover, other types of aircraft may prove to be more useful in future conflicts. The extensive use of tactical bombing in the Persian Gulf War emphasizes the value of aircraft that can attack land targets, perhaps in preference to aircraft such as the F-22, which is designed to combat enemy fighters. Given the changes in the nature of the threat, strategies other than buying expensive F-22 aircraft might better meet the Air Force's future needs. Such strategies might include upgrading existing aircraft or developing a new plane that is less capable but cheaper than the F-22.

Nor does the Air Force need to buy the F-22 any time soon to support the reduced size of its tactical forces. CBO's analysis suggests that even if the Air Force procured no fighter aircraft after 1993, it would have more than enough fighter aircraft through at least the middle of the next decade. But the Air Force will experience shortages in its overall tactical fighter fleet around the turn of the century.

The Air Force contends that the improved capabilities of the F-22 aircraft would be required even in a world in which U.S. tactical air forces are smaller and the former Soviet threat is much reduced. If the United States canceled the F-22 program, the capability of its fighters through the first decade of the next century would be similar to that of today's F-15 aircraft, which entered development in the 1960s. By the next decade, regional powers such as Iraq may possess fighter aircraft that are at least the equal of the F-15. Thus, to maintain its edge, the Air Force believes that the United States needs the improved capability the F-22 aircraft offers. The Air Force also raises concerns about escalating threats from the ground that may degrade the survivability of current aircraft. Surface-to-air missiles are cheaper and easier to operate than fighter aircraft and may be more accessible to regional powers. To counter those threats, fighters may need the improved capabilities of the F-22, including stealth and higher speed.

The F-22 may be able to perform the ground attack mission. DoD has recently announced its intention to provide the F-22 with such capabilities--a plan that may be the Administration's response to criticisms that the F-22 is less useful in regional conflicts if it is a pure fighter aircraft. The F-22's capability to attack targets on the ground may be modest, however, according to some press reports. And the F-22's ability as a bomber will undoubtedly be less than that of a plane developed primarily for the bombing mission.

DEF-13 BUY NO MORE THAN 40 C-17s AND BUY COMMERCIAL AIRLIFTERS INSTEAD

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	210	1,660	1,480	2,370	2,380[a]	8,100
Outlays	10	150	560	1,090	1,570	3,380

NOTE: The Administration has made significant changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

a. The 1995 plan for strategic airlift did not include any money in 2000 for either C-17 or commercial wide-body aircraft. CBO assumed that the Administration would need roughly $4.3 billion in 2000 (about the same amount as in 1999) to continue the procurement program.

The C-17 is a four-engine transport aircraft that can carry a cargo payload of at least 110,000 pounds for a distance of 3,200 nautical miles without aerial refueling. It is being produced as the next-generation airlift aircraft to replace the C-141 Starlifter. Because it is designed to land at relatively small airfields with short runways, the C-17 also is expected to play an important role in meeting transport needs within a combat theater and will substitute for other aircraft, such as the C-130, that traditionally perform that role.

The Congress has already authorized 32 C-17 aircraft through 1995. After an intensive review of its airlift options, the Administration announced in December 1993 that it would commit to purchasing a total of only 40 C-17s. The Administration is expected to make a decision in the fall of 1995 as to whether it will purchase additional C-17s, after reviewing how well the initial squadron of planes has been operating. The C-17's producer, McDonnell Douglas, must also demonstrate that it has lowered the aircraft's costs and reduced its manufacturing defects. If the Administration halts the C-17 program at 40 planes, it will probably purchase either new C-5 aircraft or new or used commercial wide-body jets instead. (DoD refers to those alternatives to the C-17 program as nondevelopmental airlift aircraft, or NDAA.)

The 1995 plan supports purchasing a total of 40 C-17s through 1996. The plan also contains a "placeholder" estimate to buy more C-17s, NDAAs, or a combination of C-17s and NDAAs over the period 1996 to 1999. If all of that funding for strategic airlift was used to purchase C-17s and the Administration devoted about the same amount of resources to that program in 2000 as in 1999 ($4.3 billion), CBO estimates that budget authority would be sufficient to bring the total C-17 inventory to as many as 94 aircraft.

Instead, this option would limit total purchases of the C-17 to 40 aircraft. The option would substitute purchases of 34 wide-body commercial aircraft such as the Boeing 747-400F or the McDonnell Douglas MD-11 freighter. Those purchases would provide the Air Force with roughly the same amount of airlift capability as 54 more C-17s, as measured in millions of ton-miles per day. Compared with the 1995 plan, including CBO's estimate of funding for 2000, buying no more than 40 C-17s and supplementing them with 34 commercial airlifters would save about $210 million in 1996 and $8.1 billion over the five-year period. (These estimates use Boeing 747-400F prices.)

The option would minimize purchases of an aircraft that, among other problems, has had difficulty meeting its performance goals. As part of a settlement reached in January 1994, the Department of Defense plans to lower several specifications for the amount of weight the C-17 must be able to carry, the plane's landing distance while carrying its maximum payload, and the amount of heavy equipment it can air-drop. Air Force officials claim that the original

C-17 contract specifications were based on transportation goals set during the Cold War, which are now unnecessary. But some analysts contend the C-17 will have trouble meeting even those lower performance thresholds.

Manufacturing quality has also been of concern. For example, in October 1992, the wing of the C-17 test aircraft buckled under a test load equal to 124 percent of maximum operating weight. Specifications for the C-17 contract require that the aircraft be able to withstand 1.5 times the structural stress it is expected to encounter during a lifetime of normal use. More recent wing tests have been controversial as well: the left wing failed in two areas as it neared or soon after it reached the 150 percent goal.

Costs for the C-17 program have risen dramatically. If one excludes changes in costs caused by updated assumptions about inflation and the number of aircraft to be purchased, cost estimates for the C-17 have increased by about $16 billion, or 41 percent, from the original plan. In 1993, DoD estimated that the total unit cost for each C-17, excluding costs already incurred, would be about $260 million (in current dollars) if 120 planes were purchased. That cost is likely to rise significantly if the Air Force buys fewer aircraft.

Critics also contend that the Air Force may not need as much capacity to carry outsize cargo as 120 C-17s would provide. For example, nearly half the total cargo airlifted during the early stages of the Persian Gulf War could be fit on standard pallets (so-called bulk cargo), as was nearly two-thirds of it during the peak month of airlift operations (January 1991). Civilian wide-body jets can deliver bulk cargo more efficiently than the C-17. General Ronald Fogleman, former Commander in Chief of the Air Mobility Command and the Air Force's current Chief of Staff, seemed to underscore this point when he testified in April 1994 before the House Committee on Appropriations that, given fiscal constraints, 70 to 80 C-17s might provide sufficient core airlift capability.

Opponents of this option would argue that at a time when the U.S. military is preparing to face diverse regional conflicts on short notice, the Air Force needs more of the versatile C-17 airlifters. Civilian wide-body jets cannot carry outsize cargo such as an M1 tank or an Apache helicopter. Canceling the C-17 program at 40 aircraft therefore might limit the speed with which the United States could carry out some military missions. The C-17 is also designed to be able to survive enemy attacks better than existing military or commercial airlifters; it is expected to be better able to detect and avoid missiles and antiaircraft artillery.

In addition, commercial planes are ill suited for austere environments and require long runways and special equipment to be loaded or unloaded. Without the C-17, limitations on the availability or capacity of large international airports might restrict the ability of the United States to deploy forces. That issue may be especially important given the Administration's stated goal of being able to deploy enough forces to fight and win two major regional conflicts nearly simultaneously.

DEF-14 RETIRE EXCESS KC-135 TANKERS

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	40	110	190	280	370	990
Outlays	30	90	170	250	340	880

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The U.S. Air Force owns a large fleet of tanker aircraft to refuel transports, fighters, and bombers while they are airborne. Being able to do so is important for tactical air operations and for deployment of forces by air from the United States to other parts of the world. By the end of 1995, U.S. tanker forces will consist of 478 KC-135 aircraft and 52 KC-10 aircraft (both figures reflect primary aircraft authorized--those planes available for operational use, excluding aircraft used for training).

During the past several years, most of the aircraft in the KC-135 fleet have been retrofitted with new CFM-56 engines that increase their fuel-carrying capacity. Over two-thirds of the KC-135 fleet has been or will be modernized with this engine by the end of 1995. The remainder (designated as KC-135E aircraft) have been retrofitted with less efficient engines for the Air Force Reserve and Air National Guard.

This option would retire 100 E-version aircraft--those with the least efficient engine technology and the smallest capacity for fuel delivery--at a rate of 20 planes per year through 2000. That would still leave the military with more than 425 operational tanker aircraft (including KC-10s). Compared with the 1995 plan, this approach could save about $40 million in 1996 and nearly $1 billion through 2000. Savings would be the same relative to the Administration's plan for 1996.

Historically, the tanker fleet has played an important role in the nuclear deterrence mission by supporting long-range strategic bombers. Today, however, most of the requirements for aerial refueling are derived from regional threats. The tanker fleet provides an "air bridge" for deploying conventional forces, thus reducing the amount of time it takes to place U.S. forces in distant theaters and decreasing the degree to which the United States must rely on foreign bases en route. Tankers can be used to refuel airlift aircraft, as was done to support the C-5 aircraft that carried heavy equipment into Somalia. To a limited extent, KC-135s can also transport cargo during peacetime. Once in theater, tanker aircraft support fighters and bombers, increasing their combat range and endurance. For example, about 300 tanker aircraft supported operations in the Persian Gulf War.

This option could provide enough tanker capacity to meet the requirements of future regional contingencies. The combination of planned KC-135 retirements and the changes proposed in this option would amount to a 15 percent reduction in the Air Force's total capacity for fuel delivery by 2000 compared with its current level. Relative to 1990 levels, those reductions in numbers of tankers are commensurate with the Administration's plans to reduce the number of attack and fighter aircraft by about 40 percent.

Retiring the older KC-135E aircraft would also avoid other problems. The KC-135E has a refurbished engine used formerly by Boeing 707 aircraft in commercial service. Although that engine has greater fuel efficiency than the KC-135's original engine, it gives the aircraft less capacity for fuel delivery and slightly higher operating and support costs than aircraft equipped with the more modern CFM-56 engine. In addition, the older engine does not comply with Federal Aviation Administration Stage III noise standards set for 2000. Since tankers

often operate out of airfields used for both military and commercial aircraft, the Air Force would probably have to purchase "hush kits" or put new engines in its E-version planes in the near future.

Retirement of KC-135E tankers, however, might reduce the number of KC-10 aircraft available for airlift tasks. In addition to being an aerial refueling aircraft, the KC-10 can be used as an airlifter; it is especially efficient at delivering bulk cargo. The Air Force plans to dedicate just 15 of its 52 KC-10s to air refueling missions, leaving the remainder free primarily for cargo delivery. Thus, by retiring more of the Air Force's aircraft dedicated to refueling, this option may reduce the number of KC-10s that can be devoted to airlift missions.

Moreover, the Air Force may need to rely on aerial refueling more heavily if the United States loses access to foreign bases that support airlift missions en route. During the Gulf War, three bases (Zaragoza, Torrejon, and Rhein-Main) handled 61 percent of the airlift traffic. Of those bases, one is no longer available, and it is uncertain whether the United States will have the same degree of access to the others in the future. Opponents of this option might argue that a large tanker fleet makes the United States less dependent on obtaining overflight and landing rights.

This option might leave the United States unable to wage a conventional war and a major nuclear war involving strategic bombers at the same time. However, in light of the low probability of major nuclear war and the availability of other platforms for delivering nuclear weapons that do not depend on tankers, the loss of capability is unlikely to be a problem.

Perhaps more important, this option might also limit the United States' ability to achieve the Administration's stated goal of being able to prosecute two major regional conflicts that occur nearly simultaneously. In the Persian Gulf War, the military deployed 46 KC-10 and 262 KC-135 tankers. The refueling aircraft retained under this option would be sufficient for a future deployment of similar size and would also provide capability for a simultaneous, smaller conventional deployment in some other theater or for support of a small nuclear mission that involved bombers. But such a force might not permit the United States to fight two simultaneous wars on the scale of Operation Desert Storm.

DEF-15 MAKE THE ARMY RESPONSIBLE FOR CLOSE AIR SUPPORT

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	120	310	560	960	1,200	3,150
Outlays	100	260	470	810	1,070	2,710

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

Ground forces and air forces have typically operated in the same area and provided each other with mutual support. Forces on the ground have defended air bases from attack from both land forces and enemy aircraft. Conversely, air forces--in missions referred to as close air support and battlefield air interdiction--have attacked from the air targets that are beyond the reach of ground-based weapons. Those roles have become more complex, however, as ground-based weapons--helicopters and artillery in particular--have attained the ability to attack enemy assets at longer ranges. This option would relieve the Air Force of the responsibility for providing air support to the Army. A consequence of adopting this option is that the Army would have to rely on its own assets, such as attack helicopters and artillery, to attack targets beyond the range of direct-fire weapons such as tanks.

Even though the Air Force has had responsibility for providing close air support (CAS) to the Army for the past 50 years, several defense experts have expressed concerns and doubts about the willingness or ability of the Air Force to do so adequately. The CAS mission involves attacking hostile targets that are near friendly forces and requires close coordination with the Army. Although the Air Force has an airplane, the A-10, that is dedicated solely to the CAS mission, the service has periodically attempted to eliminate all of the A-10s from its force structure. The Air Force still has 144 A-10s, but that is far fewer than the 400 it fielded in 1988. Moreover, half of the remaining aircraft are in the reserve components.

The Air Force has traditionally allotted 25 percent of its fighter aircraft specifically to ground attack missions, which include close air support as well as battlefield air interdiction (BAI). Both those missions involve attacking enemy targets on the battlefield, but in contrast to close air support, air interdiction would be directed at targets far removed from friendly forces. As the number of A-10s has declined, the Air Force has assigned increasing numbers of its F-16s to those missions. By the end of 1996, three wings of F-16s, or almost one-third of all of the Air Force's F-16s, could be designated for the CAS and BAI missions. Since the F-16s are multirole aircraft, however, they are not likely to be as well suited to the CAS mission as the A-10, which was designed specifically for it. In addition, the F-16s could be called on to perform other missions of more importance to the Air Force than CAS. All of these factors highlight the concerns Army commanders could have that Air Force aircraft might not be available when the Army needs them to provide air support.

Perhaps in response to these concerns, the Army has developed and fielded its own weapons capable of attacking ground targets beyond the reach of direct-fire weapons. The premier example of such a weapon is the attack helicopter, which can attack armored as well as soft targets and performed ably in Operation Desert Storm. In addition, the Army is developing fire-support weapons with increasingly long ranges and precision-guided munitions capable of attacking some of the targets previously accessible only by aircraft.

With the Army fielding hundreds of attack helicopters and increasingly sophisticated fire-support weapons, it may be possible to relieve the Air Force of the primary responsibility for providing CAS. That change would simplify operations since the Air Force would not have to coordinate its air strikes so closely with the Army in order to avoid attacking friendly troops. Moreover, the Air Force could retire all of its A-10s and reduce the number of types of aircraft in its inventory, thereby realizing some budgetary savings. The Army could use its currently planned level of forces--attack helicopters and artillery--to attack targets that might today be assigned to Air Force aircraft.

This option would yield significant savings if it led to the elimination of all Air Force aircraft assigned to the close air support and battlefield air interdiction missions. Retiring all of the Air Force's A-10s and about one-third of its F-16s would reduce the size of the Air Force by about five wings. Such a reduction in force could save $120 million in 1996 and nearly $3.2 billion over the next five years in operating costs compared with the Administration's 1995 plan. (CBO assumes that savings compared with the Administration's 1996 plan would be similar.)

Eliminating one-third of the Air Force's F-16s, however, could limit the Air Force's ability to carry out its other missions. The F-16 is a multirole fighter capable of performing other tasks, such as air-to-air combat, besides providing air support to the Army. Cutting the F-16 fleet by one-third and the tactical Air Force by 25 percent would represent a major reduction in the Air Force's overall capability.

Shifting primary responsibility for close air support and battlefield air interdiction solely to the Army and eliminating Air Force assets assigned to those missions would also have other drawbacks. Having multiple means of attack is a distinct advantage for a commander because it forces the enemy to defend itself against multiple threats. Thus, if the United States can attack its enemies with fixed-wing aircraft, helicopters, and artillery all at once or in rapid succession, the defender's task becomes that much harder.

Another drawback to eliminating from the Air Force all aircraft designated for the CAS and BAI missions is the loss of the ability to react and deploy quickly that is inherent in aircraft. Aircraft are often the first assets to arrive in theater, since additional time is needed to transport Army equipment, including helicopters, to trouble spots. With fewer aircraft in the Air Force inventory capable of CAS, delays may occur before significant assets arrive in theater to perform that mission. And a major lesson some observers have drawn from Operation Desert Storm is that air power can slow or even stop the advance of enemy ground forces. Sharply reducing the number of U.S. aircraft capable of providing close air support would eliminate many of the aircraft that contributed to an early victory in the Gulf War and helped to keep down the loss of U.S. lives.

DEF-16 FREEZE FUNDING FOR MILITARY SPACE PROGRAMS

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	150	60	600	1,050	1,080	2,940
Outlays	70	70	180	520	830	1,670

The United States conducts activities in space necessary for national security in the post-Cold War era. The Department of Defense's space program consists of launch vehicles, satellites, communications systems, navigation systems, related support facilities, and various space-related projects that provide assured, responsive support to military forces deployed worldwide.

The Administration's 1995 plan for military space programs, including the requests for intelligence activities, averages about $14 billion for each of the next five years, slightly higher than the $13.5 billion appropriated by the Congress for those programs in 1995. By comparison, the Congress appropriated about $14.3 billion for programs of the National Aeronautics and Space Administration in 1995. DoD's request therefore represents about one-half of all funds for federal space programs. Annual spending on military space programs would exceed $15 billion by 2000 and would total $72 billion over the next five years. During the past several years, the Congress has been concerned that those programs have lacked direction and become ineffective and costly.

This option would freeze spending for military space programs at the 1995 appropriation level, allowing for increases only to keep up with the rate of inflation. Relative to the 1995 plan, this option could save $0.2 billion in 1996 and $2.9 billion over the next five years. Savings would be about the same relative to the Administration's 1996 request because the Administration has not made many changes to the space program.

For the past two years, the House Committee on Appropriations has observed that no clearly defined national space policy exists to guide the investments and processes of military and civilian space programs. In the committee's view, the space program is poorly coordinated, unresponsive to users' needs, inattentive to potential cost savings, and lacking in clearly defined requirements. The committee reaffirmed the need for a single integrated investment strategy to reduce costs and increase efficiencies. Although the committee asked the Secretary of Defense to prepare a plan to meet those objectives, the department had not completed the report by December 1994.

Reorganizing and streamlining defense space activities could result in significant savings by reducing the size of the workforce while improving the central oversight that would promote joint activities and coordination among various defense components. According to the General Accounting Office, for example, DoD could consolidate certain space education and training programs. Consolidating the services' satellite control network could also save money.

The department could also achieve savings by revising current practices governing the acquisition and operation of space systems. For example, placing greater priority on developing smaller satellites would allow the department to move away from more expensive heavy-lift launch vehicles. The department could also establish more reliable launch schedules supported by the use of standardized interfaces and modular designs in new space systems.

Closing space support facilities, including launchpads and range support installations that exceed requirements, could also yield savings.

If not properly managed, however, a freeze in funding for military space programs could risk the loss of important military capabilities needed to support the operations of military forces. Those programs play a critical role in various national security functions including military deployments and training exercises, intelligence reporting, and support during a crisis. Operation Desert Storm used space-based systems, such as the Defense Support Program and the Defense Satellite Communications System, that played vital roles in the coalition's success. Any reductions in spending for space programs should preserve the ability to provide the support necessary to conduct such critical missions. In particular, imposing proportional reductions on all space programs below current plans could delay some that deserve high priority. Specific proposals for appropriate priorities within constant funding levels should be identified in DoD's revised plans, which may also analyze the advantages and disadvantages of alternative programs, including their impact on the industrial base, their ability to meet requirements, and potential revisions to the military departments' roles and missions.

DEF-17 REDUCE THE NUMBER OF ARMY LIGHT DIVISIONS

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	350	1,160	2,130	3,000	3,450	10,090
Outlays	290	1,000	1,890	2,710	3,200	9,090

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The active portion of the U.S. Army consists of 12 divisions, eight of which are generally regarded as "heavy"--that is, equipped with tanks and other armored vehicles. The eight heavy divisions are primarily intended to be used against other armored forces. The other four divisions, referred to as "light" divisions, are useful against less heavily armored forces and were designed to be dispatched quickly and transported easily to trouble spots around the world. They include one airborne division, one air assault division, and two light infantry divisions (LIDs). The Administration plans to eliminate two heavy divisions by the end of 1996.

The utility of the light infantry divisions has been questioned in the Congress and elsewhere since their creation 10 years ago. The Reagan Administration justified the LIDs by emphasizing the need to respond to events anywhere in the world by rapidly dispatching U.S. forces. But recent history indicates that the United States may not need those divisions. Between 1945 and 1991, about 120 incidents--excluding major conflicts such as those in Korea, Vietnam, and Iraq--required commitment of U.S. ground forces. Of those, the Army was involved in about a third and even then, generally not in very large numbers. Indeed, only 12 of those incidents required Army forces of division size or larger. One can argue that other units--including the Army's airborne and air assault forces and three Marine Corps divisions--also provide sufficient rapid response.

Other questions arise about the capability of the LIDs once they have been transported, presumably to a hostile location. With 870 jeeps, 135 motorcycles, and 41 utility helicopters for transportation, a light infantry division has limited mobility, and most of its 10,000 to 11,000 soldiers would have to move by foot. A LID also has limited firepower, particularly against an enemy with any kind of armored vehicles. Each division has only 44 long-range antiarmor missiles, 62 howitzers, and 29 armed helicopters; the most numerous antiarmor weapon in the LID--162 Dragon medium-range antitank missiles--has a limited capability against modern tanks.

Perhaps the strongest statement about the utility of the LIDs in combat was made by the Department of Defense when it failed to use any light infantry forces during Operation Desert Storm. That conflict was initiated by a relatively unsophisticated foe and occurred halfway around the world with very little warning. The need to establish some military presence in theater very rapidly would seemingly have argued for the use of light infantry forces. Nevertheless, none of the LIDs were deployed. Another telling experience has been that of the 10th Mountain Division in Somalia. That light infantry division's firepower and protection proved to be inadequate against even the unsophisticated and poorly equipped troops of a Somali warlord. As a result, parts of a heavy division were dispatched to Somalia to provide armored protection to U.S. forces there.

Questions could also be raised about the Army's need for both an airborne and an air assault division. The former is designed to be dropped by parachute into hostile territory when no seaport or airport is available for debarkation; the latter is designed to be deployed by helicopter to relatively remote locations, although the deployment must be staged from a protected area. The United States has not conducted a

parachute assault involving an entire division since World War II. Drops including one brigade--about one-third of a division--were carried out in Korea and Vietnam and in Panama in 1990. In Operation Desert Storm, portions of the 82nd Airborne were sent to the Middle East early in the operation, but they did not parachute in and, once reinforced by later-arriving heavy combat units, were assigned supporting roles and were not involved in any major battles. Additional paratroop-qualified units exist in the special-forces branch of the Army, and it is not obvious that the Army needs an entire division designed to be dropped by parachute.

This alternative would eliminate the equivalent of two of the remaining light divisions from the Army's active forces. Forces disbanded would include one of the remaining light infantry divisions and portions of the airborne and air assault divisions. To permit an orderly drawdown, the divisions would be eliminated gradually over the five-year period. The alternative would retain one light infantry division and one airborne division consisting of two air assault brigades and one airborne brigade. Compared with the 1995 plan, this alternative would save $350 million in 1996 and roughly $10 billion over the next five years. (CBO assumes that savings compared with the Administration's 1996 plan would be similar.)

Despite these savings and the shortcomings of the light infantry divisions, eliminating more of them would reduce U.S. capability in certain situations. For example, LIDs might be useful during combat in urban areas where armored vehicles could not operate easily. They might also be useful for defending areas such as airports or seaports if the enemy did not have armored capability. Finally, in a recent demonstration of the utility of light divisions, contingents from the 10th Mountain LID were instrumental in operations in Haiti. A proposal to eliminate all but one of the LIDs might also encounter political opposition because it would mean closing at least one military facility that has been activated and refurbished in recent years.

DEF-18 CANCEL THE ARMY'S TANK UPGRADE PROGRAM AND LAY AWAY PRODUCTION FACILITIES

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	590	620	520	590	640	2,960
Outlays	40	270	470	500	530	1,810

NOTE: The Administration has made significant changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

The shrinking of the U.S. military, coupled with the disappearance of a long-time foe and the unprecedented peacetime investment in modern weapons that occurred in the 1980s, has sharply reduced the need for new weapons. In particular, the Army now has enough of the latest type of tank, the Abrams, to equip the forces it plans to have for the foreseeable future, and so has no plans to buy new tanks for at least the next 15 years.

The Army has proposed instead to upgrade about 1,000 M1s--the first model of the Abrams tank--to a later configuration designated as the M1A2. That program is intended, in part, to increase the capability of some of the tanks that the Army will have in the field for the next 20 years and in part to keep producers of tanks and tank parts in business, pending the need for a tank to replace the Abrams.

During the Bush Administration, the Army advocated closing the tank production line and putting it in mothballs. In March 1992, then Chairman of the Joint Chiefs of Staff General Colin Powell testified before the Congress that the Army's current tank is the best in the world. That testimony disputes the Army's current rationale for upgrading tanks, which is based on the need for better ones. Indeed, although the M1A2 is 20 percent more capable than the M1 model--as measured by one scoring system developed for the Defense Department--converting 1,000 M1 tanks to the M1A2 model would increase the total capability of the 7,880 Abrams tanks in the Army's inventory by only 3 percent. That slight increase in capability would come at a high price--a total of about $3 billion over the next five years.

This alternative would cancel the Army's upgrade program but would retain the components of the tank industrial base in a mothballed status. Mothballing the government-owned facilities that manufacture tanks and components could cost nearly $400 million over the next five years. By preserving the facilities, however, the United States would retain the capability to produce tanks again when the next generation is needed to replace the Abrams or in the event of a crisis that would require more Abrams tanks. Compared with the 1995 plan, savings from adopting this alternative would amount to about $590 million in 1996 and would total nearly $3 billion over five years. Savings compared with the Administration's 1996 plan would be slightly less--$480 million in 1996 and $2.6 billion through 2000.

Closing the tank line would also have some disadvantages. Without an upgrade program, the U.S. inventory would include only very small numbers of the most capable M1A2 tanks. As regional powers acquire improved tanks, the absence of M1A2s might erode the U.S. advantage in a war, even though the M1A1 remains a highly capable tank. Closing the tank line would also end U.S. capability to produce large numbers of new tanks quickly. The Army estimates that producing new M1A2 tanks at high rates from a mothballed line could take six years--about one year more than to produce large numbers of new tanks from a line involved in modifying tanks.

Perhaps the most important drawback of this option is that some businesses that currently manufacture tank components might close and so be unavailable to produce tanks in the event of a crisis. A

related concern is the potential loss of workers whose skills are unique to tank manufacture and who would have to be retrained in order to perform up to government standards. Even though Defense Department officials have asserted that the United States currently has enough capable tanks to meet any foreseeable contingency and that there would be enough time in the event of a major crisis to restart the tank line, shutting the tank line down completely carries some risks. Those risks have to be weighed against the hundreds of millions of dollars that would need to be spent annually to provide insurance against them.

DEF-19 CUT SPENDING FOR DUAL-USE TECHNOLOGY PROGRAMS TO HISTORICAL LEVELS

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	960	990	1,100	1,100	1,170	5,320
Outlays	420	810	990	1,050	1,110	4,380

NOTE: The Administration has made significant changes to its 1995 plan for these programs. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

In recent years, the Congress and the Administration have expanded funding for research and development (R&D) on dual-use technologies--those that have both civilian and military applications. One new program that has been financed with part of this increase is the Technology Reinvestment Project. TRP provides support to consortia that develop or disseminate dual-use technologies; it is administered by the Department of Defense's Advanced Research Projects Agency (ARPA) in cooperation with the three military departments and five other federal agencies. In most cases, recipients of TRP awards must match their federal support dollar for dollar.

Several other dual-use programs have also received considerable funding increases over the past several years, including R&D in high-performance computing, electronics processing, electronics modules, and electric vehicles. Those programs are administered by ARPA, whose technical managers are given considerable independence in selecting technologies and managing projects. Organizations that receive R&D awards from ARPA are not necessarily obligated to share project costs, although some do.

For 1995, the Congress appropriated $550 million for TRP and more than $1 billion for other dual-use programs. The Administration, which has a strong commitment to technology policy, supports continued funding in 1996 and beyond. This option would cancel the TRP and reduce funding for other dual-use initiatives to their 1992 levels. Relative to the Administration's 1995 plan, savings would be nearly $1 billion in 1996 and about $5.3 billion over the five-year period. Compared with the Administration's 1996 request, savings would be $800 million in 1996 and about $3.2 billion through 2000.

Advocates of greater funding for dual-use technologies contend that those programs ultimately will help to lower the cost of defense equipment. Although military R&D has spawned numerous commercial applications, today some civilian products outpace their defense counterparts and are less expensive, particularly those in the field of microelectronics. By incorporating widely available components from the commercial sector, some defense equipment could be made more capable while keeping costs reasonable. Programs such as ARPA's efforts in electronics processing may help to adapt commercial technologies for military use.

Initiatives such as TRP may also improve the integration of the defense industrial base into civilian sectors of the U.S. economy. Historically, military and civilian production have been treated as two distinct sectors because of onerous cost-accounting requirements and detailed specifications for military products, among other factors. But as U.S. military spending has declined, integrating those sectors in order to meet future military needs has become more important. Some analysts fear that, otherwise, only a few companies would remain in the defense business and retain the capability to produce sophisticated military equipment. That could become a problem if threats to national security emerge that would need advanced technology to counter them.

Advocates believe that dual-use programs can bolster economic growth in certain industries, espe-

cially high-technology ones. For example, flat-panel displays, which are used widely in laptop computers, also have many important uses in defense equipment. The Administration has proposed spending nearly $600 million over five years on flat-panel displays through a combination of funds from ARPA, TRP, and the Department of Energy awarded on a cost-sharing basis. DoD officials hope to cultivate a domestic manufacturing industry for flat-panel displays by awarding dual-use R&D funds to companies that promise to build production facilities in the United States. Under this line of argument, U.S. companies would be better positioned to capture a share of the growing commercial market for flat-panel displays, and the Defense Department would have a reliable supplier for its military needs.

Critics of direct funding for dual-use R&D argue that other policy changes can encourage the integration of civilian and military efforts more effectively. Adopting commercial standards in place of military specifications, for example, might allow weapons producers to incorporate civilian components on a more widespread basis than would, say, an ARPA-sponsored study in which commercial technologies are customized for military use. Dual-use programs that tailor civilian technologies to defense specifications could leave too little in common with the commercial marketplace, thereby defeating one of the key purposes of dual-use items: to benefit from economies of scale in production.

Ultimately, dual-use programs may not be sufficient to sustain domestic suppliers of high-technology goods. One example can be found in the GCA Corporation, which received funding from SEMATECH, an ARPA-sponsored consortium of private companies that was established, in part, to ensure the viability of domestic suppliers of equipment for manufacturing semiconductors. SEMATECH provided GCA, one of the few U.S. producers of photolithography machinery, with funding to boost the technical sophistication of its equipment. Nonetheless, sales prospects dropped off, and in 1993, GCA closed its business. Dual-use programs also cannot control whether companies that develop technology with their help share those innovations with foreign firms, even though such sharing may undermine the objectives of the program.

Moreover, these dual-use programs sponsor a type of R&D for which the grounds for government funding are less clear. Most economists believe that federal support for basic research is justified because the private sector will underinvest in research of that type. More contentious, however, is the degree to which the government should support applied R&D, the type funded by TRP and most dual-use programs. As projects move from underlying scientific knowledge closer to products and processes, the commercial benefits of that R&D are likely to become more apparent. Applied research projects could take numerous paths, and it is difficult to select a few projects from among several promising applications and then evaluate critically the role of federal support. Some analysts therefore contend that the private sector--with its vested interests in identifying commercial potential--is better suited to promote applied R&D projects. Furthermore, if supported with federal funds, R&D programs can become entrenched politically and difficult to discontinue.

DEF-20 REDUCE THE BASIC ALLOWANCE FOR SUBSISTENCE OF ENLISTED PERSONNEL

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	95	225	365	510	660	1,855
Outlays	90	220	355	500	650	1,815

Although originally intended to defray a portion of the cost of subsistence for service members not receiving rations in kind, since 1974 the basic allowance for subsistence (BAS) has generally been raised in lockstep with military basic pay. In part as a result, the money that a typical enlisted service member receiving BAS spends on the food he or she consumes at home is probably less than the amount of his or her allowance (which is higher than what officers receive). The U.S. Department of Agriculture regularly estimates the cost of food at home for various families and individuals; the enlisted allowance is greater than the cost for a typical male adult in a family of four under all but the most liberal of the USDA food plans. Thus, in addition to its intended role as compensation for the lack of government-provided meals, BAS has served as an income supplement for enlisted members who receive it.

The role of the basic allowance for subsistence in supplementing income is particularly important for very junior married personnel, whose seemingly low pay levels have received special attention in the wake of reports that many military families may be receiving food stamps. For a married person in the lowest enlisted pay grade, BAS averages 13.5 percent of total compensation (including the tax advantage that accrues because subsistence and housing allowances are not subject to federal income tax), compared with only about 8.4 percent for all married enlisted personnel. To some extent, however, the concerns about low pay levels are misplaced: even the most junior married enlisted person receives total compensation that exceeds the total family income of nearly 20 percent of U.S. families and half of all young families (those headed by a person under age 25). The use of food stamps apparently derives less from low total compensation than from the way the military's quarters allowance is administered: married personnel living in government quarters are not paid a cash allowance and so, having a lower cash income than their counterparts living off-base, are more likely to qualify for food stamps. According to the Department of Defense, 40 percent of the military families receiving food stamps live on-base, although overall only about 20 percent of the families of members in the three lowest enlisted pay grades live on-base.

The harmful effects of a too-generous subsistence allowance became apparent during Operation Desert Shield/Desert Storm. Many military families were suddenly, and unexpectedly, deprived of the income supplement when their service members were deployed to the Persian Gulf (and lost BAS because they received government rations). Although families' food costs may indeed have fallen, their income fell by even more. Many perceived that as an unfair burden to place on families already hurt by the members' sudden departure. To address this problem in the subsequent deployment of troops to Haiti, the Defense Department adopted a stopgap policy that resulted in the services' paying BAS to all enlisted personnel in Haiti, regardless of whether they had been entitled to it before the deployment, as well as feeding the deployed troops.

This option would reduce BAS for enlisted personnel to a level equivalent to that for officers (currently $146.16 per month), phased in over five years. The most common form of enlisted BAS, which is given to people on leave or authorized to mess separately (for example, single personnel authorized to live off-base and to receive a quarters allowance, and married personnel accompanied by their dependents), would eventually be reduced by 31 percent, to $4.81 per day at 1995 rates compared with the current

$6.98. Compared with BAS costs under current law and the Administration's 1995 plan for reducing military personnel levels, the option would save $95 million in 1996 and a total of $1.9 billion over the 1996-2000 period. Additional savings might accrue if the change in BAS rates prompted DoD to abandon the interim policy of paying BAS to all troops in certain deployments. Some of the savings might be offset if a targeted pay raise or some other measure was used to counter specific problems arising from the option (see below).

Linking the BAS rate for enlisted personnel to that for officers reflects an essentially arbitrary choice. Alternatively, the rate could be based on one of the four USDA food plans. Food costs for a male adult age 20 to 50 in a family of four under the low-cost plan (second lowest of the four) are slightly lower than the current allowance for officers, and under the moderate-cost plan are about $28 per month higher. The thrifty plan (lowest cost) is used in determining food stamp payments; costs under the liberal plan (highest cost) are roughly the same as the current enlisted BAS level.

The option would have two major advantages in addition to the obvious one of reducing defense expenditures. First, as suggested above, it would reduce or eliminate the problem of families of deployed service members experiencing a decline in living standard (albeit at the cost of reducing their disposable income at other times). Because the allowance would no longer include an income supplement, the income lost when the member deploys would be roughly offset by the reduction in the family's total food costs. Second, the option would eliminate an inequity in the current system that favors married personnel and others who receive a subsistence allowance over people who must eat in government messes, many of whom are single junior personnel. The former receive a payment that probably exceeds their actual food costs; the latter apparently incur out-of-pocket costs on the occasions when they do not eat in the mess halls--about 44 percent of all meals. To a small extent, the cut might discourage some married people from entering the military and some single personnel already in the military from marrying. Some observers might see that as an advantage and others as a disadvantage.

The option achieves its savings by cutting the total compensation of a majority of enlisted personnel. That approach might be undesirable for two reasons. First, it would probably reduce personnel retention and could make recruiting more difficult--both traditional areas of concern. Second, the most junior personnel eligible for BAS would suffer the largest percentage reduction in compensation because the dollar amount of the allowance is the same for all enlisted pay grades.

Although the income of junior enlisted personnel may not be as low as is sometimes thought, that group would definitely be hardest hit by this option. The BAS cut would reduce the total compensation of very junior married personnel by about 4 percent--twice as much as for senior noncommissioned officers. Offsetting the reduction for junior personnel through an increase in basic pay for the three lowest enlisted pay grades would cost about $300 million per year, based on 1995 pay rates. That possible offset is not reflected in the savings shown in the table.

DEF-21 RESTRUCTURE OFFICER ACCESSION PROGRAMS

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	145	240	340	445	450	1,620
Outlays	110	205	305	410	435	1,465

The military services have drawn on several management tools to reduce the size of the officer corps. They have encouraged voluntary separations through specific actions such as tightening criteria for promotion and liberalizing early-out procedures. They have reduced the number of senior officers by selective early retirement, and they can make further cuts through reductions in force if necessary. Finally, the military services have reduced the number of new officers (accessions) who enter the force each year, consistent with the projected smaller force.

This option would restructure officer accession programs beyond the changes the Department of Defense has already made. Overall accession levels would not be cut below the level planned by the department, but more officers would be drawn from lower-cost commissioning programs--Reserve Officer Training Corps (ROTC) and Officers Candidate School/Officer Training School (OCS/OTS)--and fewer from the more costly service academies. In addition, a ceiling would be placed on the per capita amount that could be spent on each recipient of a ROTC scholarship. Further, the option would cut Junior ROTC programs and eliminate the preparatory schools operated by the service academies. Relative to the Administration's 1995 plan, savings would be about $145 million in 1996 and a total of $1.6 billion through 2000.

Of that total, $1 billion would come from cutting class size at the three service academies. At present, each academy graduates about 1,000 second lieutenants or ensigns a year. This option would reduce that number to 625 by cutting the size of the entering class for the three academies from a total of 3,000 to only 1,875. Estimated savings from that action reflect only the costs that would change in the near term, such as faculty and cadet pay and operating expenses. Those savings would be offset by the additional costs of about $70 million over the five years that would be needed to procure officers from OCS and ROTC to replace those from the academies. In the longer term, savings also might accrue from changes in the academies' physical plant.

Additional savings under this option would stem from changes in the structure of ROTC programs. In 1995, DoD plans to spend $280 million for ROTC scholarships. (DoD covers other costs of education, but this option deals only with tuition.) About 40 percent of ROTC students now attend private institutions. The average cost per student in 1994 for tuition at four-year private institutions, based on data from the Department of Education, was $11,000 a year, more than four times the average cost of $2,500 at public universities. The option would cap ROTC scholarships at the $2,500 level consistent with average tuition at public institutions. Under a cap, DoD might choose to reduce the number of programs at high-cost institutions, reallocating resources to lower-cost schools in order to maximize the number of officers trained. Alternatively, the department might elect to pay only a fraction of total tuition at high-cost institutions, requiring the student to make up the difference. Students currently enrolled would be allowed to complete their education without financial penalty.

Further, this option would cut Junior ROTC programs by about 25 percent. Junior ROTC provides introductory military training and uniforms to students in secondary school, at an overall cost in 1995 of $160 million. Recent Congressional action significantly expanded Junior ROTC in an effort to place more programs in the inner cities. The reduction

called for in this option would restrict that expansion by 50 percent. DoD could retain programs in urban areas or elsewhere. Savings would be $40 million in 1996 and $220 million over five years.

Finally, the option would close the preparatory schools operated by each service academy. Those schools accept students who cannot meet the stringent admission criteria of the academies and gives them a year of additional training and schooling so that they can gain entry to an academy. Savings in 1996 would be about $20 million and would total about $120 million through 2000.

Supporters of the military academies have contended that those programs are needed to produce future service leaders. This argument has not persuaded the Congress, but past attempts to mandate cuts at the academies have been only partly successful; class size has declined modestly, but academy graduates now account for a larger share of officer accessions than at any time since at least 1980. There is little evidence for the contention that the academies have already reduced their class size to the minimum efficient level, as supporters have claimed in arguing that further cuts would not produce savings.

Opponents of a dollar ceiling on ROTC scholarships might argue that the quality of a graduate from a private institution is higher than that of a graduate from a public institution. Setting a cap--and limiting the number of accessions from private institutions--thus might reduce the overall quality of the officer corps. However, the national security benefits of paying the higher tuition at private schools are unclear at best. Supporters of the public educational system might claim that the quality of education at public schools equals that provided at private ones.

Proponents of Junior ROTC include many Congressional supporters who contend that it provides discipline and reinforces positive values for teenage youth, particularly in inner-city schools. Nonetheless, the program's contribution to national security is difficult to measure, and if its benefits lie in the behavioral changes it encourages, it arguably should be funded in competition with other social programs targeted toward such populations.

Similarly, supporters of the service academies' preparatory schools claim that those schools are needed to provide an opportunity for students from less fortunate circumstances to enter the military academies. Those schools also provide an avenue for enlisted personnel to enter the academies. Opponents argue that the schools are used to enable the academies to recruit athletes and minorities who cannot otherwise qualify for admission, and that at an average total cost of about $40,000 per student they are more expensive than most other secondary education or than OCS/OTS programs, the primary avenue of commissioning for enlisted personnel.

DEF-22 RESTRUCTURE THE BONUS PROGRAM FOR PILOTS

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	2	6	11	17	25	61
Outlays	2	6	11	16	25	60

Since 1989, the U.S. Air Force has projected an overall shortage of pilots, in part because of the departure of pilots to the commercial sector. In order to address the shortage, the Air Force has undertaken several initiatives including paying its pilots bonuses. Under the Aviator Continuation Pay (ACP) bonus program, which the Congress authorized in 1989, pilots who qualify can receive up to $12,000 a year for agreeing to remain on active duty through their 14th year of service. At present, the Air Force pays all pilots of fixed-wing aircraft the same bonus regardless of which weapon systems (fighters, bombers, tankers, strategic airlift, theater airlift, or trainers) they fly.

The Air Force has made good use of the ACP program. However, in part because of the military drawdown and the subsequent reduced need for pilots, some major weapon systems (namely, tankers and theater airlift) will probably have a surplus of pilots. Under this option, the bonus would be made available only to pilots of major weapon systems for which shortages are projected. Moreover, bonus payments would vary according to the degree of shortage. Relative to the Administration's 1995 plan, this option would save $2 million in 1996 and a total of $61 million through 2000.

Precedents exist for targeting bonuses in this manner. For example, the Navy uses this approach in providing bonuses to its pilots. Furthermore, several types of military pay are targeted in accordance with the degree of personnel shortage, including special and incentive pay for physicians and recruiting and reenlistment bonuses for enlisted personnel.

The Air Force historically has opposed targeting bonuses in that way, arguing that doing so would adversely affect morale, possibly exacerbate retention problems, and ultimately increase pilot shortages. Moreover, the Air Force maintains that pilots would object to a bonus system that would result in internal inequities, since they all endure similar hardships during peacetime and face the same substantial risk in war. However, whether all pilots share that view is arguable. Combat pilots, for instance, face different risks and deployment patterns than transport or tanker pilots.

DEF-23 RESTRUCTURE RESERVE COMPENSATION

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	125	235	410	595	780	2,145
Outlays	120	225	390	565	740	2,040

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

In 1995, more than 900,000 people will serve part time in the reserves, with personnel costs of roughly $6 billion. Those reservists typically participate in 48 training drills per year, which usually involve one weekend of reserve duty each month, and also serve on active duty for two weeks each year. They are compensated with pay and allowances for time spent training as well as with credit toward military retirement benefits.

This alternative would make three changes to the reserve compensation system that would save about $125 million in federal budget authority in 1996 and a total of more than $2.1 billion through 2000 compared with the Administration's 1995 plan. Annual savings would continue to grow in the years beyond 2000. In addition to realizing savings, this alternative would aim to equalize active and reserve service for pay purposes, to treat different categories of reservists more equitably, and to improve efficiency in personnel management.

Treat Reserve Service Like Active Service for Pay Purposes. Part-time reservists, like their active-duty counterparts, receive periodic pay increases in three basic ways: in annual across-the-board raises intended to keep military pay competitive with civilian pay, through promotion to higher pay grades, and through longevity increases based on years of military service. Under the current pay table, longevity increases can contribute as much as or more than promotion raises to total career earnings, particularly for officers. On average, longevity increases raise basic pay by about 5 percent and generally come every two years.

A reservist receives the same credit toward longevity raises from a year of part-time work as does an active-duty person serving full time. Typically, however, reservists serve only about 60 days a year (including, for many personnel, days for which they are not paid). A person with 10 years of part-time reserve service, for example, is paid at the same rate as a counterpart in the same grade with 10 years of full-time service, even though the reservist will have served far fewer days. In calculating credit for retired pay, however, the reserve compensation system recognizes this difference. The reservist receives four points for each weekend (two drill periods each day, worth one point each), one point for each active-duty day, and an additional 15 points each year just for remaining affiliated. A total of 360 points earns the same credit toward retired pay as does one year of service for an active-duty member.

This option would put part-time service on the same point basis for determining raises based on longevity that is used for determining retired pay. In general, one "year of service" for pay purposes would require about five years of part-time duty--longer for people who meet only the minimum service requirements and less for those who put in substantial additional time. Thus, on average, reservists would tend to receive longevity increases at intervals of roughly 10 years instead of the current two years. Past service, however, would continue to be counted as under the current system; that is, past service would be grandfathered. Compared with the system under current law, this alternative would save about $40 million in 1996 and $1.7 billion over the 1996-2000 pe-

riod. Annual savings would continue to grow in later years as more of the total accumulated reserve service time was covered by the new system.

Eliminate Dual Compensation for Reservists Employed by the Federal Government. More than 120,000 reservists are employed in civilian jobs in the federal government. Those people benefit from the government's strong support of reserve training and may experience fewer conflicts with employers than do reservists who work in the private sector. In addition, reservists employed by the government receive dual compensation during their two weeks of annual training--both their government and reserve pay--without having to use vacation time or annual leave. Although a few of the larger private-sector employers mirror this government pay practice, dual compensation is not the general rule for reservists who are employed outside the federal government.

This alternative would eliminate dual compensation for reservists who are given time off from their federal jobs to carry out their active-duty commitment. Instead, they would receive only the higher of the two payments during the service period. Savings would be about $90 million in each of the five years. This particular proposal has been included in the National Performance Review initiatives.

Eliminate Reserve Retirement. The United States is the only country that offers retirement benefits to its part-time military personnel. Those benefits parallel the ones provided for active-duty service and have remained largely unchanged since their enactment in 1948. Reservists are entitled to retired pay at age 60 after 20 years of active or reserve service, but at least the last eight years must have been spent in the reserves. The amount of retired pay is based on length of service and the average highest three years of pay. Payments to reserve retirees in 1993 totaled $1.9 billion. In 1996, DoD will set aside an amount equal to 9.6 percent of reservists' basic pay, or roughly $350 million, to pay for their future retirement benefits.

This option would terminate reserve retirement for people entering the reserve components after the end of fiscal year 1995. The federal government would not realize savings for many years because the actual payments would not occur until those new reservists reached age 60. Officers would be affected most because they receive about 80 percent of the total amount of retirement benefits paid to reservists, even though they constitute only 15 percent of reservists.

Although these three changes offer potential advantages, they could also raise problems. The changes would be imposed during a period of considerable turmoil caused by the reduction in the number of military personnel, including reserve personnel. Broad changes in the compensation system may be easier to effect once the drawdown is complete.

More important, these changes would result in lower paychecks for reservists and would eliminate their retirement benefits, which could lead to problems in retention and possibly in recruiting. Retention already is lower among reservists who are at the early stages of their reserve career than among their active-duty counterparts. These changes, however, would tend to have their greatest effects on career retention. In the long run, lower career retention would result in younger, more junior reserve forces, which might even be seen as an advantage. In addition, personnel who remain would probably see their opportunities for promotion improve, offsetting some of the effect of less frequent raises based on longevity and the lack of retirement benefits.

The military could target bonuses toward those reservists most in demand, making payments at various points during reservists' careers to retain those with needed skills. Bonuses could also be used to recruit new reservists into occupational areas that are difficult to fill. Added costs for bonuses, however, are not reflected in the savings noted above.

The military could also use these bonuses to phase in the retirement changes more quickly, by offering reservists a choice between continuing under reserve retirement or potentially receiving bonus payments. Reservists choosing bonus payments would then forgo future retirement benefits.

DEF-24 DENY UNEMPLOYMENT COMPENSATION TO SERVICE MEMBERS WHO VOLUNTARILY LEAVE MILITARY SERVICE

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	265	270	265	270	275	1,345
Outlays	265	270	265	270	275	1,345

Many military personnel who leave active-duty service are eligible for unemployment benefits. Their payment amounts are calculated in the same way as those of civilian personnel who qualify for unemployment benefits. However, eligibility of former military personnel differs from that of recipients in the civilian labor force in one important respect. Former military personnel can apply for and receive unemployment benefits even if they voluntarily leave military service, but civilian recipients must have lost their job involuntarily.

The majority of personnel who leave military service do so voluntarily. For example, many choose not to reenlist following completion of their term of service; others, who have completed a minimum of 20 years of service, opt for voluntary retirement. Still others may choose to leave military service in return for cash payments under the voluntary separation incentive and special separation benefits programs enacted in 1991. A much smaller group is separated involuntarily for reasons related to job or promotion performance or, in recent years, because of the drawdown of military forces.

This option would apply the same rules to former military personnel that other members of the civilian labor force must follow by stipulating that only personnel who left service involuntarily because of force reductions would be eligible to receive payments. Eliminating payments to people who leave service voluntarily would reduce the number of recipients by at least two-thirds, resulting in savings of about $270 million annually. Because the Department of Defense ultimately reimburses the Department of Labor for the cost of unemployment payments to former service members, those savings would occur in the defense budget.

The unemployment insurance program was established with the intent of aiding people who lose their job involuntarily. Subjecting military personnel to the same rules as the rest of the workforce regarding unemployment compensation thus could be seen as a more equitable use of an existing entitlement program. But if military service is considered to be fundamentally different from other types of employment, one could argue that voluntary separation from service is not comparable with voluntary termination of civilian employment and therefore should not be subject to the same restrictions on eligibility for unemployment compensation.

DEF-25 CLOSE THE UNIFORMED SERVICES UNIVERSITY OF THE HEALTH SCIENCES

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	20	30	40	80	80	250
Outlays	10	30	40	70	80	230

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

Historically, the Department of Defense has faced shortages in medical personnel, particularly physicians. To alleviate that situation, DoD has developed various programs to provide a supply of those personnel. One such program is the Health Professionals Scholarship Program (HPSP), which pays tuition and a stipend to medical students and to students in other health-related programs in return for a military service obligation. Another example is the Uniformed Services University of the Health Sciences (USUHS), a medical school operated by DoD.

The Congress created the university in 1972 to train physicians committed to long-term military careers. At a total cost of about $100 million in 1994, the school provides a full education for its participants, including a stipend to cover room, board, and books. Based on figures from 1994, USUHS is the most expensive source of military physicians at $562,000 per person. By comparison, scholarships cost $125,000, and other sources, such as the Financial Assistance Program (FAP) and the Volunteers Program, range in cost from $19,000 to $58,000. Even after adjusting for the lengthier service commitment required of physicians trained at USUHS, their training cost is still higher than for physicians from other sources.

USUHS has met only a small fraction of DoD's need for new physicians--less than 12 percent in 1992, for example. Scholarships provided about 73 percent, and the remaining 15 percent came from other sources, including volunteers.

This option assumes that the class of students admitted in August 1995 would be USUHS's last; the institution would close at the end of fiscal year 1999 after those students have graduated. Other programs for obtaining physicians would be expanded to offset the loss of physicians trained at USUHS. CBO's estimate of the Administration's 1995 plan, as modified by Congressional action, assumes continuation of the USUHS program at current levels. Compared with that plan, net federal savings would be about $20 million in 1996 and $250 million over five years. Those savings include reductions in military and civilian personnel assigned to the university and would be in addition to planned drawdowns. They also reflect the added cost of obtaining physicians from other sources, such as the HPSP and FAP. But because DoD would not lose the first class of physicians trained at USUHS until after 2000, this estimate of savings does not reflect the additional outyear cost to the federal government of maintaining a steady supply of physicians. Including those additional costs would lower cumulative five-year savings to the federal government by about $130 million.

Fiscal year 1995 was a year of controversy for USUHS. Despite the Administration's recommendation to close the university at the end of fiscal year 1997, the Congress directed DoD to keep USUHS open. In its reasons for doing so, the Congress cited many of the arguments of the university's supporters. Those supporters claim, for example, that USUHS physicians are better trained for the special needs of the services because of the university's focus on the study of military medicine and preparation of military medical officers. In addition, some of the higher costs of USUHS are repaid, in effect, because USUHS-trained physicians have a longer service

commitment than physicians from other sources. For example, graduates of USUHS must pay back seven years of active duty, whereas scholarship recipients must pay back only about one year of active duty for each year of health professional training. The longer tenure of USUHS graduates may enhance stability in the medical corps and reduce demands on the other sources of physicians.

Supporters of USUHS also argue that direct cost comparisons between it and other sources of physicians may be unfair to the university because of indirect subsidies that the federal government provides to medical schools, which in effect raise the true governmental cost of physicians from sources other than USUHS. Nonetheless, taking those subsidies into account would lead to the dubious conclusion that closing USUHS would increase the amount that the federal government spends on indirect subsidies to medical schools.

DEF-26 ADOPT HMO STAFFING PATTERNS IN MILITARY MEDICAL FACILITIES

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	20	50	80	110	110	370
Outlays	10	50	80	100	110	360

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

In December 1993, the Department of Defense announced its plans to reform the military health care system by establishing a program of managed care nationwide, referred to as Tricare. Ensuring that people who are eligible for health care from the military have access to high-quality health care benefits and improving the efficiency of the military health care system are two of the major goals of the Tricare program. DoD has already introduced a new approach to delivering and financing health care in the military to encourage coordination among the Army, Navy, and Air Force and to provide them with strong fiscal incentives to control costs. When fully implemented, Tricare will also introduce several managed care strategies, which have been adopted by many civilian plans, to improve the cost-effectiveness of the system.

This option, building on the incentives under Tricare, would require DoD to adopt staffing patterns at the military medical facilities based on the standards used by civilian health maintenance organizations (HMOs). HMOs are generally accepted as a cost-effective way to deliver care to a defined group of enrollees by controlling their use of health care and delivering services as economically as possible.

Putting HMO staffing patterns into effect could lead to substantial savings for DoD by reducing the overall number of physicians the military employs. Civilian HMO staffing standards suggest that DoD would need 8,090 physicians. That number is based on the assumption that roughly 5 million beneficiaries seek care from military medical facilities worldwide; the number is adjusted upward for differences in age and sex of military beneficiaries and civilian HMO enrollees. Recognizing other key differences between military and civilian HMOs, such as training and the services' readiness requirements, the number of physicians needed would rise to 12,130. At the end of fiscal year 1996, however, DoD plans to have about 13,420 physicians--or about 1,290 more than required for the military in this option. By having fewer physicians, DoD could lower health care costs by about $20 million in 1996 and nearly $370 million over the next five years, in comparison with the Administration's 1995 plan. These estimated savings are in addition to those resulting from the drawdown already planned for uniformed and civilian physicians. The estimates of savings also assume that HMO staffing standards would be phased in over three years.

Even though adopting HMO staffing patterns would be consistent with the department's move toward managed care for the military, this option has some drawbacks. HMO staffing patterns assume significantly lower levels of health care use by enrollees than is true for the military beneficiaries who currently use the military's medical facilities. Therefore, reducing the number of military physicians would decrease the access of beneficiaries to military medical care.

The higher rates of health care use by military beneficiaries compared with HMO rates, however, underscore the differences in practice patterns between military physicians and those who work in civilian HMOs. Unless military physicians changed how they practice medicine, reducing the number of physicians could lead to rationing or poorer service. That said, phasing the HMO staffing patterns in over

three years, as this option assumes, might mitigate many of the potentially adverse effects of those cutbacks on beneficiaries. That phase-in period would allow physicians some time to understand the variations in clinical practice patterns between HMOs and the military and to modify their behavior accordingly. DoD could support those efforts by expanding existing discussions and working groups, which currently focus on understanding clinical variations among the services, to understanding more far-reaching differences in practice patterns among physicians.

A more serious problem that relates directly to the issue of care is the possibility that the number of eligible military beneficiaries electing to use the military health care system might grow. With more beneficiaries, the problems of excess demand, rationing, and declines in the quality of service would be greater than assumed here, because the number of physicians assumed in this option might not be sufficient to meet HMO staffing patterns for the military.

In view of these uncertainties, this option makes the conservative assumption that beneficiaries receive all of their health care at military medical facilities, though currently they actually receive about 20 percent of their care from civilian providers paid by DoD. Indeed, accounting for the care that beneficiaries receive from civilian providers could lower the number of physicians needed to meet civilian HMO staffing standards by as much as 20 percent--or from the 8,090 assumed here to 6,740.

DEF-27 REVISE COST SHARING FOR MILITARY HEALTH CARE BENEFITS

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	210	200	200	200	200	1,000
Outlays	180	190	200	200	200	970

About 8.2 million people are eligible to use the military health care system. That total includes all men and women on active duty, their spouses and children, and retired military personnel and their dependents and survivors. Those who choose to use this health care system receive most of their care in the military's hospitals and clinics (referred to as the direct care system). When beneficiaries receive care in military facilities, they pay very little. Hospital care costs between $4.75 and $9.50 per day for most beneficiaries; retired enlisted personnel pay nothing. Outpatient visits and prescriptions are free of charge for all beneficiaries.

When direct military care is unavailable or inaccessible for dependents and retirees under the age of 65, the Department of Defense reimburses civilian providers through a traditional fee-for-service insurance program, the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS). Compared with cost-sharing requirements in military facilities, beneficiaries using CHAMPUS generally pay more. For inpatient care, for example, retirees must pay the lesser of $323 per day for inpatient care or 25 percent of hospital charges. For outpatient care, all users face both a deductible and copayments. The lower charges for military facilities lead to patterns of higher use of health care there and are inequitable to beneficiaries who must rely on civilian providers.

This option would equalize the cost-sharing requirements for outpatient care for all beneficiaries regardless of whether that care is received in a military or civilian setting. As a consequence, this option would address the twin problems of efficiency and equity. New cost-sharing requirements for direct military health care would be modeled after the civilian cost-sharing requirements for the health maintenance organization option proposed under Tricare, the program suggested by DoD for establishing a managed care plan nationwide. Savings could amount to about $210 million in 1996 and about $1 billion through 2000 compared with the 1995 plan. Those savings stem from both the revenue generated from increased charges and the reductions in patterns of use by beneficiaries in response to higher cost sharing. Some of those savings, however, would be offset by the cost of modifying existing automated information systems to collect the higher fees.

The principal reason to revise the cost-sharing requirements for the military health care system is to slow the rising costs of providing military health care. Controlling those costs will be possible only if both beneficiaries and providers face improved incentives of the kind incorporated in DoD's Tricare plan for care received in the civilian sector. Implementing that plan for military beneficiaries, however, need not impose onerous requirements on them, because it should improve their access to less expensive care at military medical facilities.

Aside from raising revenue, this option would yield many other benefits. Higher charges for military care would help curb excessive use in military facilities by creating the same incentives for beneficiaries who use the military treatment facilities as for those who use civilian providers. This option would eliminate the inherent inequity of providing more generous health care benefits to people who live near a military hospital or clinic.

There are disadvantages to this option. Because medical care is a key part of military compensation, military families might view increased charges as an

erosion of benefits. That may be of particular concern during a major drawdown of forces, which has already created considerable uncertainty among military families. Recruitment and especially retention could suffer, although enrollment in Tricare would be free, in contrast to the premiums typically required for enrolling in other medical plans offered to civilian employees in either the federal government or the private sector. Nor should rising charges necessarily harm health, because evidence shows that people at ages and incomes typical of military beneficiaries seek needed care even when they share costs.

DEF-28 CONSOLIDATE PILOT TRAINING AND DELAY BUYING THE JOINT PRIMARY AIRCRAFT TRAINING SYSTEM

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	200	370	610	720	810	2,710
Outlays	30	140	350	510	670	1,700

NOTES: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The Administration has made significant changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

The United States invests substantial resources in training its military personnel, on the premise that well-trained fighting forces are most likely to win wars quickly with the fewest deaths. To provide personnel with the necessary skills to serve effectively in combat or support units, the services train individuals at various training bases, often in a classroom setting.

With the drawdown in force structure, the total amount of individual training that is needed has dropped substantially. For example, the amount of pilot training, one of the most expensive types of individual training, dropped by half between 1985 and 1995, as measured in training loads, which reflect both the number of students and the length of the course. Based on the amount of training conducted in the past at the 12 flight-training bases in use today, the services together have almost twice as much capacity to train pilots as they need.

The Army, Navy, and Air Force each operate separate training establishments for pilots. Leaders in both the Congress (Senators Goldwater and Nunn) and the Department of Defense (General Powell and Secretary Aspin) have proposed consolidating pilot training. The study of roles and missions that the Joint Chiefs of Staff sent to the Congress in 1993 also recommended consolidating undergraduate training for pilots of fixed-wing aircraft and evaluating the consolidation of training for rotary-wing (helicopter) pilots. Current plans for consolidation, however, call for only a modest exchange program between the Navy and the Air Force, affecting only some 10 percent of the undergraduate training for pilots of fixed-wing aircraft in 1998. DoD would gradually expand the joint training between 1998 and 2010 as it purchases the new training aircraft--the Joint Primary Aircraft Training System (JPATS)--but it has no plans to consolidate helicopter training.

This option would consolidate undergraduate training of pilots in all services. Capitalizing on similarities in the skills learned during the initial phase of flight training, this option assumes that all Navy and Air Force pilots of fixed-wing aircraft would undergo common core training using the T-34 aircraft, the Navy's current trainer, rather than wait for delivery of the new JPATS trainer. The T-34 is inexpensive to operate and should be available in sufficient numbers to train both Navy and Air Force pilots at least through the middle of the next decade. One service would conduct this training at two bases rather than the four bases used now. At the same time, the Army, Navy, Air Force, and Coast Guard would all conduct their basic helicopter training under one service and in one location, using the current fleet of Navy and Army training helicopters. This option would change the current practice by which all Navy and Marine Corps pilots train initially in fixed-wing aircraft, including those who later become helicopter pilots.

Consolidating the services' pilot training programs and delaying the procurement of JPATS would result in five-year savings of $2.7 billion compared

with the Administration's 1995 plan. DoD could delay procurement because the Navy's T-34 would be used for most of the Air Force's fixed-wing training. Since the T-34 has many remaining years of service life and the Navy has a sufficient inventory, DoD could delay buying JPATS until early in the next century. In addition, DoD would need to purchase about 120 fewer JPATS aircraft, because Navy and Marine Corps personnel designated as helicopter pilots would no longer initially train in fixed-wing aircraft. Savings from the Administration's 1996 budget would be $1.6 billion. These savings are lower because the Air Force and Navy have delayed the JPATS program.

Continuing to rely on the T-34 for fixed-wing training and delaying the purchase of JPATS would mean that the Air Force and Navy would not reap the advantages of using a new trainer until a later date. Those advantages include an ejection seat that operates at ground level, a digital cockpit common to aircraft that pilots will later fly, the ability to train at higher altitudes, and a redesigned cockpit to accommodate smaller people, making it easier for women to become pilots. The Air Force considers the T-34 aircraft unacceptable for its training needs, primarily because it lacks those features. Although the T-34 does not have an ejection seat, DoD considers it safe. In addition, if the Air Force individually screened pilots who did not meet physical size requirements, as the Navy does now, about 80 percent of female pilot candidates could train in the T-34. That is the same standard required of the new JPATS aircraft.

Consolidating pilot training could improve training, reduce the size of the training infrastructure, and reduce operating costs. Training jointly could lead to the adoption of "best practices" from each service and foster interservice cooperation, which is increasingly important as the United States turns to joint operations in response to crises. Since all training of a particular type would be conducted at one or two bases, the services would be able to close three or four of the 12 flight-training bases, eventually saving about $180 million each year. The cost of operating training aircraft would also be lower because the Navy's T-34 costs about half as much to fly as the T-37, the Air Force's current trainer. In fact, jointly conducting initial training would reduce current operating costs by $10 million annually and would save over $400 million through 2000 by retiring T-37 aircraft that would no longer be needed. The services could, however, face one-time costs to move aircraft between training bases and to close bases.

The Navy, Marine Corps, and Coast Guard would all object to adopting common helicopter training because they prefer that their helicopter pilots receive initial training in a fixed-wing aircraft. The Navy believes that such training improves its ability to select the highest-quality pilots for fixed-wing fighter training. Recent research suggests, however, that relying on other methods to select fighter pilots would be almost as effective. The Marine Corps and the Coast Guard prefer to train all their pilots in fixed-wing aircraft initially because a few of their pilots fly both fixed- and rotary-wing aircraft. Under this option, those pilots would undergo both types of training.

DEF-29 REDUCE FUNDING FOR DEFENSE ENVIRONMENTAL PROGRAMS

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	400	411	423	434	447	2,115
Outlays	196	349	396	416	433	1,790

Although real defense spending has declined by about 26 percent since 1990, funding for environmental security programs has increased by more than 300 percent. In 1990, the Department of Defense spent $1.6 billion on environmental programs for cleaning up operational bases and closing military installations, complying with federal and state standards in handling hazardous waste materials, and conducting research and development of environmental remediation technologies. For 1995, the Congress has appropriated $5.2 billion for those activities--$400 million less than the Administration requested. The Administration's 1996 plan includes about $5.1 billion for environmental programs in 1996 and $22.1 billion over the 1996-2000 period.

Compared with the 1995 plan as modified by the Congress, this option would save $400 million in 1996 and $2.1 billion through 2000. Those savings would result from adopting less stringent cleanup standards, reducing management costs, and using new remediation technologies. Such changes in DoD's environmental programs would be consistent with concerns expressed by oversight committees in the Congress.

Despite the recent dramatic increase in funding for environmental programs, DoD has achieved only limited progress in cleaning up the 19,694 contaminated sites on its 1,722 installations. Most of the work to date has involved identifying and characterizing contamination, and little actual cleanup has been accomplished. As of March 1994, the department reported that cleanup activities were complete or under way at about 5 percent of the total number of contaminated sites that require remediation.

The Congress has expressed concern about the lack of progress being made in the cleanup program and--despite the overall growth of funding for cleanup in recent years--has indicated that, in some instances, reductions in funding may be warranted. For example, for 1994 the Congress appropriated about $350 million less than the department requested for the Defense Environmental Restoration Account (DERA). The House Committee on Appropriations had recommended an even larger cut, concluding that less stringent cleanup standards could provide significant savings. In 1995, House and Senate conferees from the armed services committees authorized $150 million less than the department requested for DERA. Subsequently, conferees from the appropriations committees cut the defense request further, appropriating about $1.8 billion--$400 million less than DoD's request. Legislative efforts to revise the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 could change the cleanup process and standards of remediation. That could significantly affect DoD's current cleanup plans and requirements. Moreover, in the face of such uncertainty, the House Appropriations Committee questioned the department's ability to obligate funds even as appropriated for 1995.

Although adopting less stringent cleanup standards and improving the remediation process would yield savings for DoD, applying more efficient technologies for characterizing and cleaning up contaminated sites could produce even larger savings. The department might achieve near-term savings by revising sampling and analysis practices during the early phases of the cleanup process. For example, a DoD study of five contaminated sites found that the

application of statistical design techniques in sampling to characterize and monitor contamination could save as much as 30 percent compared with the cost of current approaches. In addition, new technologies, such as the Site Characterization and Analysis Penetration System, a type of ground radar, accounted for savings of an additional 7 percent compared with past practices. DoD estimates that the application of these new techniques could save between $56 million and $246 million for some 900 sites requiring characterization work. The study also concludes that more effective characterization could save significant costs, perhaps billions of dollars, during the remediation phase.

Savings might also be achieved during the next several years by applying certain new technologies during the remediation phase. For example, the current cost of cleaning contaminated soil by incineration varies from $350 to $1,500 per ton. Bioremediation techniques, such as composting, can achieve the same standards at a considerably lower price--between $100 and $400 per ton. Recent cleanup work under way at Umatilla Army Depot in Oregon confirms that composting is an effective alternative to incineration.

Application of new technologies for treatment of fuels and solvents in groundwater also has the potential for considerable savings during the next few years. Current technologies such as air stripping and activated carbon adsorption cost between $5.00 and $7.50 per 1,000 gallons of contaminated groundwater. The department estimates that by 1996, crossflow air stripping with catalytic oxidation could reduce costs to as little as $1.50 per 1,000 gallons.

But the policy changes underlying the estimated savings are not without risk. The savings estimates for site characterization are based on a limited number of samples and may not be achievable for all contaminated sites. Similarly, DoD's estimated savings for applying new technologies during the remediation phase are based on laboratory results and reflect only limited experience in the field.

Also, the potential savings from the application of new technologies during the characterization and remediation phases of cleanup may not be realized as quickly as DoD has estimated. Few of the new remediation technologies are mature enough to be used on a wide scale during the next year or so. Thus, a disproportionate share of the near-term savings assumed in this option may have to be achieved through management changes.

Finally, unless the Congress takes separate legislative action, the possibility of realizing savings by adopting less stringent cleanup standards is subject to the vicissitudes of negotiation among the Department of Defense, the Environmental Protection Agency, and the states. In some cases, such as George and Mather Air Force bases and the Rocky Mountain Arsenal, disagreements among DoD, EPA, and the states occurred and more stringent cleanup standards were eventually adopted. Less stringent standards could be agreed upon in other cases, but in any event, the resulting standards remain a matter for negotiation.

DEF-30 REDUCE FUNDING FOR DOE'S CLEANUP PROGRAM

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	600	620	650	670	690	3,230
Outlays	300	520	630	650	680	2,780

NOTE: The Administration has made significant changes to its 1995 plan for this program. See Appendix B for estimated savings compared with the Administration's fiscal year 1996 request.

The Department of Energy (DOE) is responsible for operating, maintaining, and cleaning up the large complex that develops and produces nuclear weapons. In 1989, the Environmental Restoration and Waste Management (EM) program was created within DOE to oversee and direct all aspects of that cleanup. Since that time, the program's annual budget has more than tripled, from slightly under $2 billion in 1989 to over $6 billion in 1995. The Administration has requested more than $6 billion in budget authority for 1996 and plans to budget a total of about $30 billion in the next five years. Most of those funds are devoted to defense-related cleanup activities, but approximately 10 percent would be spent on projects not related to national security.

As budget levels for the program remain high, so do concerns regarding the efficiency and feasibility of the program as it is currently structured. This option would reduce spending in this program by 10 percent below the Administration's plan in each year from 1996 through 2000. Savings would be realized by reducing spending for administrative and support functions and by delaying some projects in the environmental restoration program. Relative to the Administration's plan for 1995, savings would be $600 million in 1996 and a total of $3.2 billion through 2000. Savings would be $670 million in 1996 and just under $3 billion through 2000 relative to the Administration's 1996 plan. Almost 90 percent of those savings would be realized in budget authority in the defense function (050).

One concern voiced both by critics outside DOE and by high-level managers within the department is that the EM program is not being managed efficiently. Several factors contribute to the perception that significant portions of EM funds are being wasted on unnecessary administrative and support activities. At each of DOE's 15 major sites, a single management and operations (M&O) contractor is responsible for all phases of on-site operations. In some cases, the same contractor is responsible both for weapons production and for cleaning up any wastes resulting from that production. DOE also contracts with an additional firm at many sites for architectural and engineering (A&E) work. Some critics of DOE have argued that this arrangement has led to duplicate layers of bureaucracy and administration as both the M&O and A&E contractors subcontract for the performance of specific tasks. In addition, until recently, contracts between DOE and M&O contractors were subject to less scrutiny than other government contracts, and many contained clauses that were unusually favorable to the contractors. DOE and its predecessors justified those unusual contracting practices based on the unique and secret work performed at the nuclear weapons complex.

Several reviews of the budget for the EM program conducted by both internal and external review teams have found excessive levels of funds devoted to management functions. In the past, the Congress has directed DOE to reduce those costs, and the Assistant Secretary of Energy for EM has acknowledged the potential for savings in this area. Means suggested for achieving such savings include reforming the contracting process, eliminating unnecessary programs or those duplicated elsewhere in the federal

government, and tightening oversight of contractors' performance. DOE has made some effort in the past year to reform its management practices. As a consequence, the Administration's plan for the next five years probably reflects some savings that would result from implementing the reforms. Nevertheless, DOE can probably find additional savings.

Another concern often expressed about DOE's cleanup effort is that in many cases DOE does not have any techniques for effectively cleaning up its contaminated groundwater and soil. A large portion of DOE's funds allotted to remediation are devoted to cleaning up contaminated groundwater, soil, or buildings--tasks that are difficult and expensive to accomplish with today's techniques. At the same time, DOE is investing its own money to develop new techniques to perform those tasks more quickly and cheaply. Delaying remedial actions that are difficult to accomplish with today's techniques until more efficient methods are available could not only save DOE money and time in the long run but also yield budgetary savings in the near term.

By reducing funds dedicated to administrative and support functions and delaying some remediation projects, DOE could achieve significant savings--perhaps on the order of 10 percent--over the next five years. Savings of that magnitude in annual budgets have been discussed by previous reviewers of the EM budget. Moreover, changes sufficient to generate those savings might be acceptable to the many parties involved in cleanup efforts. For example, an agreement signed last year by DOE, the federal Environmental Protection Agency (EPA), and state regulators stipulated that savings of more than 10 percent would be achieved at the Hanford site over the 1994-1998 period.

Reducing total EM funding by 10 percent, however, could cause problems for DOE. Reducing funding for administration and support without specific proposals for realizing savings could hamper execution of the program rather than make it more efficient. Although the Congress does not have direct oversight of administrative costs and so cannot eliminate or reduce them directly, it could mandate savings and instruct DOE to realize them through better management. Alternatively, it could require DOE to provide the Congress with more information, thus enabling better Congressional oversight.

Reducing funding for remediation programs could also have drawbacks. DOE feels it must proceed with many difficult and expensive remediation projects because it is required to do so by the agreements it has signed with various states and EPA. Those agreements stipulate when DOE must start and finish many cleanup tasks. Delaying projects would require renegotiating at least some of those agreements. Furthermore, some remedial action may be required immediately in order to protect the environment or public health. Finally, if long-term benefits are to result from delaying technically difficult projects, DOE might have to invest additional money in the meantime to develop better technologies to execute the projects more efficiently. Those investments might reduce the savings available under this option unless they can be accompanied by larger cuts in support or other activities.

The budgetary savings estimated in this option are associated with improving the efficiency of the cleanup program in its current structure. Substantial additional savings are possible if the program is fundamentally altered. Such fundamental change could result if the Congress decides to require risk assessment and benefit-cost analysis in setting priorities and determining the goals for cleaning up hazardous waste sites. Such provisions could be included in legislation to reauthorize the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), which governs the Superfund program. In 1994, the Congress considered but did not pass reauthorization of CERCLA.

The magnitude of budgetary savings would depend on the specific requirements set forth by the Congress. Substantial savings could be achieved by accepting lower standards of cleanup on sites destined for industrial use, by postponing action where the risks to workers involved in the cleanup would be high relative to the risks of not cleaning the site but continuing to monitor it, and by allowing greater flexibility in the choice of remedial action.

DEF-31 INCREASE RELIANCE ON PRIVATE-SECTOR HOUSING FOR MILITARY FAMILIES

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	670	670	660	650	620	3,270
Outlays	100	350	520	630	670	2,270

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

More than two-thirds of the military families in the United States receive cash housing allowances and either rent or purchase housing in the private sector. The rest (approximately 30 percent) forfeit their cash housing allowances and live in housing units provided by the Department of Defense. DoD's policy is to rely on cash allowances wherever the private sector is able to provide adequate, affordable housing. Nonetheless, CBO projects that the percentage of military families in the United States living in DoD housing will increase from 30 percent to 38 percent between 1990 and 1999. In the long run, that increase means higher costs for DoD because the average annual cost of providing DoD housing (including the amortized cost of construction) is approximately $11,000 per unit, compared with approximately $7,000 for housing allowances.

Increased use of DoD housing could also push up costs over the next several years. Most of DoD's U.S. inventory of family housing was built early in the Cold War, when domestic housing was in short supply and when DoD first faced the task of rotating a large standing army between assignments in the United States and overseas. Those housing units are near the end of their service life. Significant budgetary savings are possible in the near term if, rather than replace or revitalize its existing stock, DoD retired those aging units and relied more on private-sector housing.

The current system of housing allowances, however, discourages reliance on the private sector. Families have a strong financial incentive to live in on-base housing because the allowances do not fully cover the cost of obtaining private-sector housing. Despite DoD's stated policies regarding reliance on the private sector, it will be difficult for the department to reduce its role as a direct provider of housing when there are long waiting lines for existing on-base units.

This option would change the incentives that military families and DoD housing managers face. Under this option, all military personnel eligible for family housing would receive cash housing allowances regardless of whether they lived in DoD or private-sector units. Families choosing to live on-base would be charged rent. Rents for each type of housing unit at each installation would be adjusted based on the actual demand for those units; rents would fall when there were vacancies and rise when there were waiting lists. DoD would continue to operate existing units as long as the rent--the value of the unit to military families--covered DoD's operating costs. It would authorize revitalization or replacement, however, only in locations where the value of the unit to service members (the rent level) was at least as great as the cost of operations plus amortized construction costs.

Total savings compared with CBO's estimate of the Administration's 1995 plan could amount to $670 million in 1996 and $3.3 billion through 2000. Some of the savings would derive from more efficient management of existing units: for example, the metering of utilities lowers energy costs (metering becomes equitable under a rental system since units with low energy efficiency would rent for less than other units), and eliminating the waiting lists yields savings in turnover of units and moving costs. Other savings would derive from lower revitalization and replace-

ment costs, since existing DoD units would be revitalized or replaced only in locations where the rent that service members were willing to pay covered the full cost to DoD of providing the units. Still other savings would come from reduced federal Impact Aid for schools; since on-base housing is not subject to local property taxes, the Department of Education pays federal Impact Aid to local governments to offset the cost of educating the children who live on-base.

These savings assume that rents for only 25 percent of existing DoD units would meet the criteria for revitalization or replacement. The estimates reflect the cost of raising the housing allowances to hold constant the total out-of-pocket cost incurred by service members (the difference between their total expenditures on housing and the total amount of allowances provided). Holding those costs constant ensures that the savings shown above reflect real savings in resources, not just a transfer of dollars from the pockets of service members to DoD.

In the long run, a rental system for DoD housing would allow the department to provide service members with the same quality of life at lower cost. It would provide better signals about the value of DoD housing to service members and would encourage them to take into account the full costs of their choice when considering whether to live in on- or off-base housing. A rental system would also eliminate the costs and frustrations associated with the current system of rationing through waiting lists. The quantity and location of DoD housing units would be determined based on the preferences of military personnel. For example, rent levels for DoD units could signal the value of additional DoD units in areas where service members prefer to live on-base because the crime rate is high in the surrounding civilian community.

Disadvantages of this option include the costs of determining initial rental rates, setting up utility metering, and collecting rents. Special arrangements would have to be made for historic units (units that DoD must maintain even if rents do not cover operating costs) and for personnel who are required to live on-base to be available in the event that military needs arise (approximately 3 percent of all personnel). Since a rental system might have to be phased in as individuals started new tours, inequities might exist initially between people under the old system and those under the new. The option would also redistribute benefits: families who preferred to live in the private sector would be better off because of the higher allowances; families who preferred the on-base lifestyle would for the first time face the full cost of their choice.

Questions arise, however, about whether this is an appropriate time to consider such a change. On the one hand, decisions about revitalizing and replacing the 40-year-old housing stock must be made soon, which suggests that the market signals a rental system could provide would be particularly helpful right now. On the other hand, a major change in housing policies may be inappropriate while the services are conducting a large drawdown and many military personnel are anxious or uncertain about their career.

DEF-32 ELIMINATE FEDERAL SUPPORT OF COMMISSARIES

Savings from the 1995 Plan	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	120	230	340	460	480	1,620
Outlays	90	200	310	430	460	1,480

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The Department of Defense operates approximately 330 military commissaries in the United States and overseas. These commissaries are like grocery stores, selling food and related products to military members, retirees, and their dependents. Commissary shoppers save an average of just under 25 percent compared with shoppers in conventional civilian grocery stores. Commissaries are able to charge lower prices than do civilian grocery stores in part because commissary sales are exempt from local sales taxes and in part because the Congress provides approximately $1 billion in direct appropriations to pay for salaries of commissary employees, transportation of goods to overseas stores, and other operating costs.

This option would phase out appropriated funding for commissaries gradually over four years, forcing the commissaries either to become self-sustaining or to close. Commissaries in urban areas that face stiff competition from commercial discount grocery stores would be among the most likely to close. Commissaries in isolated locations where military members have few alternatives for shopping might be able to maintain their customer base but would be forced to charge higher prices. To help offset the impact that higher commissary prices and reduced access to commissaries would have on the quality of life of active-duty personnel, half of the savings from reduced subsidies--roughly $500 million per year by the end of the phaseout period--would be used to increase funding for cost-of-living allowances for active-duty personnel in high-cost areas. Taking the cost of that increase in allowances into account, this option would save $120 million in 1996 and a total of $1.6 billion over the 1996-2000 period.

Although commissaries were established in 1866 to provide food and related items to military personnel assigned to remote posts, the current commissary system has far exceeded that original purpose. Commissaries are now open to retired personnel and their surviving spouses, certain personnel involuntarily discharged from service, disabled veterans and their surviving spouses, reservists, and officers of the Public Health Service, among others. In addition, commissaries are no longer limited to remote locations: there are now five stores in the Washington, D.C., area alone. Ending federal support for commissaries might force the system back toward its original purpose and reduce inappropriate competition between these subsidized, federally owned grocery stores and privately owned stores. Moreover, a system of direct cash payments to military members living in high-cost locations--payments that would permit military members who live off-base to shop in private stores near their home--has the potential to provide a higher quality of life at a lower cost than does a system of federally subsidized stores.

This option has important drawbacks. Retirees and other non-active-duty personnel who benefit from the commissary systems would clearly suffer a decline in their quality of life under this option. Commissary benefits are regarded by many military personnel as an integral feature of the military way of life. Even if increased cash allowances would be preferable to commissary benefits in the eyes of most

military personnel, eliminating the subsidy for commissaries could be perceived as an attack on the military. Terminating such a popular benefit in the midst of the turmoil associated with a major reduction in the number of military personnel may not be appropriate.

DEF-33 REDUCE THE DoD CIVILIAN ACQUISITION WORKFORCE

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	50	195	530	1,030	1,760	3,565
Outlays	50	190	520	1,015	1,735	3,510

NOTE: This table includes estimated net savings in the federal budget. See Appendix A for estimated savings in the Department of Defense budget.

The Department of Defense has reduced its civilian workforce substantially since the late 1980s, in keeping with the overall reductions in its force structure. Total defense civilian employment decreased from about 1.1 million employees in 1988 to about 873,000 in 1995, a reduction of some 20 percent. As a part of the overall cutback, the department reduced the number of civilian jobs allocated to acquisition (the development and procurement of weapon systems and items needed to support military operations) by a similar proportion--about 23 percent--during the same period.

Today, DoD acquisition agencies employ approximately 425,000 civilian workers. DoD plans to reduce the size of its total civilian workforce by an additional 14 percent during the next five years. Presumably, future reductions in the number of acquisition jobs will continue to approximate those in the overall civilian workforce. This option proposes a reduction of 10 percent in civilian acquisition jobs beyond the reductions in the Administration's 1995 plan. That action could save about $3.6 billion over the next five years.

The department could reduce the number of civilian acquisition personnel and achieve significant savings through streamlining and consolidating the existing military command structure that governs defense acquisition. That task is carried out by 10 major organizations among the three services, the Defense Logistics Agency, and a number of small components in various defense agencies. Although numerous internal reorganizations have occurred within these commands, DoD has not undertaken a comprehensive overhaul of the acquisition command structure itself. The only significant revision occurred in 1992 when the Air Force merged three commands into the Air Force Materiel Command. As a result of that reorganization and the overall defense drawdown, about 34 percent fewer civilian employees worked for the Air Force Materiel Command in 1994. Previous consolidations that created unified agencies such as the Defense Logistics Agency and the Defense Mapping Agency have also resulted in fewer jobs and greater efficiency. Depending on how it is planned, however, reorganization could require initial expenditures if personnel and equipment need to be relocated. Such initial expenditures could offset savings in the short term and delay their realization.

Some Members of Congress have proposed forming a single defense civilian acquisition agency, estimating that by doing so DoD could reduce the number of acquisition management personnel by between 25 percent and 30 percent. However, although consolidation could reduce the size of the workforce, a single acquisition agency may not be appropriate in view of the separate characteristics of the services' purchasing needs. Such an agency would still consist of components dedicated to developing, procuring, and supporting land combat vehicles, ships, aircraft, and other major systems. Given the redundancy in the current organizational scheme, consolidations could occur without requiring a complete overhaul of the acquisition bureaucracy.

Reforming the acquisition process could also achieve savings and reduce the need for civilian workers. The Federal Acquisition Streamlining Act of 1994, for example, includes a variety of measures

to simplify the acquisition process. Raising the threshold requirements for cost and pricing data and for procurement actions that would trigger government oversight, for example, promises to reduce the department's management burden considerably. DoD expects to save billions of dollars by relying more on commercial products than on costly military specifications in purchasing goods and equipment. The department is also reexamining the current process that governs procurement of major weapon systems. The review, which is headed by the Defense Acquisition Board and supported by the services' own acquisition management structures, is intended to reduce overhead and to ensure that "the fewest number of people are involved, and coordination minimized."

Although such reforms could result in efficiencies and the need for fewer employees if they are successful, past efforts at procurement reform have not generated the major breakthroughs the department and the Congress have hoped for. Nearly every Administration in the past three decades has undertaken steps to reform the acquisition process. Yet acquisition costs for weapons continue to increase beyond initial expectations. Reducing the size of the civilian workforce before policy reforms have proved their effectiveness could jeopardize their potential to be integrated effectively into the acquisition process.

Reducing the acquisition workload could also help to lower personnel requirements during the next five years. Cutbacks in the number of acquisition workers have generally corresponded to reductions in the procurement workload over the past six years. For example, acquisition spending declined by almost 28 percent from 1988 to 1994, compared with a 23 percent reduction in the number of civilian acquisition workers. DoD has reduced its planned acquisition spending over the next five years by more than $17 billion, suggesting that fewer workers might be needed.

In addition, the services are purchasing considerably fewer weapons than in the past. In 1990, for example, DoD bought 392 fixed-wing aircraft; this year the Administration has requested authorization to purchase only 74. The Navy is purchasing many fewer ships, and the Army is no longer building new tanks. Moreover, the services are developing fewer new systems to manage. In 1991, the Defense Acquisition Board oversaw 131 major programs compared with only 93 in 1994.

DEF-34 ENCOURAGE PRIVATE OWNERSHIP OF INDUSTRIAL ASSETS USED IN DEFENSE PRODUCTION

Savings from the 1995 Plan	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	310	320	330	340	360	1,660
Outlays	230	300	330	340	350	1,550

Contractors producing goods and services for the Department of Defense currently hold $9 billion worth of government-owned industrial plant equipment (IPE) and other plant equipment (OPE). IPE includes metal presses and milling machines that are widely used in industry; OPE includes items such as commercial computers, filing cabinets, and desks. Believing that private ownership would be more economical, DoD officials have sought since the early 1970s to reduce the department's role in providing such assets.

This option would facilitate DoD's efforts to reduce its inventories of both types of equipment. It provides for legislation that would grant the General Services Administration (GSA) clear authority to negotiate the sale of equipment to the holding contractor in situations in which continued DoD ownership is not necessary but the contractor requires the equipment for defense production. Moreover, in future contracts in which the contractor can demonstrate that it is in DoD's best interest to provide equipment, contractors would have to obtain the assets from DoD on an explicit rental or lease basis. Rental charges for DoD-owned equipment would encourage contractors to invest in their own equipment. (Under the current system, the department does not charge contractors rent for the use of IPE and OPE in defense production; instead, DoD benefits to the extent that providing such assets lowers the prices of the goods and services that contractors provide.)

DoD's desire to reduce its role in providing industrial assets to defense contractors appears to be justified. Contractors complain that the costs of tracking such equipment in accordance with government standards sometimes outweighs the value of the assets. Government auditors report that items are sometimes lost and that contractors hold on to unneeded or underused items rather than return them to DoD. The costs DoD incurs in providing industrial equipment are not fully reflected in the estimates of weapon system costs that are used in making program decisions. The benefits to DoD--the lower prices paid for the goods and services that contractors provide--are uncertain. Because contractors are generally not free to use DoD assets to produce goods and services for non-DoD customers, they may be discouraged from integrating defense and commercial production and may thus lose economies of scale. Moreover, contractors with access to assets supplied by the government may have little incentive to invest in more modern and efficient equipment.

DoD's efforts to reduce inventories, however, have not been very successful. The total value of industrial and other plant equipment appears to be rising. Improved reporting of assets may be partly responsible for that increase, but another factor is that GSA lacks clear authority to conduct negotiated sales of IPE and OPE to the contractors who hold those assets. (GSA already has the authority to conduct such negotiated sales of real property that DoD identifies as necessary for defense production but feels it does not have to own.) By providing that authority, this option would permit DoD to divest itself of IPE and OPE without disrupting the work of the contractors who are using those assets in defense production.

DoD has also found it difficult to enforce policies that limit the provision of DoD-owned equipment to contractors while still giving program managers the flexibility to provide equipment when it is in DoD's interest to do so. Program managers may have an

incentive to try to help contractors and reduce measured program costs by authorizing the use of DoD equipment whenever they can. The rental payments required under this option would eliminate that incentive by making the costs of DoD-provided equipment clearly visible. The Defense Logistics Agency or the GSA could be responsible for setting rents at levels that would fully amortize the cost of the equipment and the overhead costs associated with its management (including the costs of carrying inventories). Faced with such rental prices, contractors would have a strong incentive to purchase their own equipment.

CBO estimates that savings under this option could amount to $1.7 billion between 1996 and 2000. That estimate reflects reduced purchases of new equipment for the use of contractors but does not include revenues from asset sales. Although sales of federal assets reduce the deficit in the short run, they do not count as savings under the provisions of the Budget Enforcement Act. Over the long run, part of the savings from fewer government purchases of OPE and IPE would be offset by higher prices for defense goods. Some savings would remain, however, since contractors who provided their own capital would try to use it efficiently and would not have to bear the cost of monitoring and tracking government-owned assets.

The need to set explicit rental prices and enter into rental agreements with contractors is one disadvantage of this option. In practice, however, rental agreements would be needed only when it was in the government's interest to provide equipment and when renting was more attractive to the contractor than either a negotiated purchase from DoD or a purchase from a commercial source. Another potential disadvantage is that the government might not receive as high a price in a negotiated sale as it would if the asset was declared excess federal property, removed from the hands of the contractor, and sold to the highest bidder. Limiting GSA's authority to conduct such sales to a three- to five-year period might alleviate this concern while still permitting DoD to reduce existing inventories of industrial and other plant equipment.

DEF-35 RECOVER THE FULL COST OF MILITARY EXPORTS

Addition to Current-Law Receipts	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Budget Authority	110	120	210	230	250	920
Outlays	110	120	210	230	250	920

The United States now exports more military equipment and services than any other country, a position held by the former Soviet Union during the 1980s. From 1990 through 1993, total arms transfer agreements worldwide fell by 40 percent from the previous four-year period. In contrast, U.S. arms transfer agreements increased both in volume and in world market share during the latter period; in 1993, the United States was responsible for nearly 70 percent of all transfer agreements. Economic concerns rather than Cold War competition have now become the primary motivation for arms sales, and with the end of the Cold War, the need to subsidize global alliances has greatly diminished. Indeed, Russia has terminated most of its grant agreements and now pursues arms exports as a means of earning hard currencies.

This option would reinstate a policy of full cost recovery to U.S. foreign military sales programs by reversing recent changes in U.S. laws and regulations. If the government recovered the full cost of arms sales, its additional receipts would be $110 million in 1996 and $920 million over five years. That estimate assumes that the amount of new arms sales agreements will fall compared with recent levels as importing countries focus on sustaining existing weapon systems. Lower subsidies are estimated to have little effect on sales.

Specifically, this option would eliminate several different subsidies now provided for foreign arms sales. It would reimpose charges for nonrecurring research, development, and production on licensed commercial exports of major defense equipment and charges for the use of U.S. government-supplied plant and production equipment on all sales. That would recoup some of the U.S. government's investment. In addition, the option would require that the administrative surcharge include the full cost of civilian and military personnel who work on foreign military sales.

Proponents of subsidizing military exports argue that the exports forge important ties between the United States and foreign military leaders. They also contend that having U.S. equipment would facilitate joint operations involving U.S. and foreign forces. They argue that significant increases in the cost of military exports would adversely affect the U.S. defense industrial base. Exports are also an important source of business and employment for defense industries. Advocates of arms sales claim that each billion dollars of exports supports 20,000 to 25,000 jobs in defense industries.

Opponents counter that concerns about the proliferation of weapons outweigh the benefits of protecting the U.S. defense industrial base. They argue that no economic studies have shown that demand for military equipment would be sensitive to the modest price increases proposed in the option. They contend that military exports can harm importing countries by contributing to destabilizing regional arms races, increasing the destructiveness and violence of regional wars, and draining resources away from civilian investment.

This option takes no position on the merits or demerits of arms sales programs. It notes only that U.S. defense industries have significant advantages over their foreign competitors and thus should not need additional subsidies to attract sales. Because the U.S. defense procurement budget is nearly twice that of all Western European countries combined, U.S. industries can realize economies of scale not

available to their competitors. The U.S. defense research and development budget is five times that of all Western European countries combined, which assures that U.S. weapon systems are and will remain technologically superior to those of other suppliers. The military and political ties with the United States associated with the sales are also an important benefit to many foreign countries. No other country can offer the same military or logistical assistance in times of crisis as the United States.

Perhaps most important, the elimination of government subsidies might encourage discussions about nonproliferation with other arms exporters. By demonstrating the threat posed by regional conflicts, the Persian Gulf War generated calls for new approaches to controlling the proliferation of conventional weapons, especially within the Middle East. The United States began a series of discussions with the other permanent members of the United Nations Security Council with the intention of establishing a mechanism of notification and consultation to curtail destabilizing arms sales to that region. Those discussions faltered when China ended its participation following the United States' sale of F-16 fighter aircraft to Taiwan. As those events suggest, promoting arms sales for economic reasons can have serious diplomatic and security implications that may outweigh economic concerns.

DEF-36 CEASE SUPPORTING MULTILATERAL DEVELOPMENT BANKS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	1,531	1,674	1,717	1,828	1,903	8,653
Outlays	178	424	754	1,097	1,297	3,750
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	1,586	1,795	1,902	2,136	2,253	9,671
Outlays	185	450	808	1,195	1,446	4,084

The World Bank was established 50 years ago to finance the reconstruction of Europe after World War II. The bank and its regional counterparts--the Inter-American Development Bank, the Asian Development Bank, the African Development Bank, and the European Bank for Reconstruction and Development--are an important source of financing for developing countries. These multilateral development banks are owned by 177 member countries and have assets of $220 billion. The banks have grown over the years through periodic increases in their stock. Member nations participate in the stock increases by directly purchasing the stock or by promising to back the banks' debts (termed callable-capital stock). The banks finance much of their lending activities by borrowing in the private credit markets. In addition, member countries contribute funds that the banks lend to low-income countries on highly concessional terms.

The World Bank and its counterparts have come under sharp attack recently. The major criticisms are that the multilateral banks have harmed the economies and people they were supposed to help, that some of the projects they have funded have damaged the environment, and that the banks' managers are overpaid and out of touch.

Under this option, the United States would continue to be a member and stockholder in the banks but would stop supplying new capital. The federal government would fulfill its currently authorized commitments but would not agree to new stock purchases or additional contributions. Adopting this approach would save $1.5 billion in 1996 and $8.7 billion over the next five years compared with the 1995 funding level. Savings would be higher--$1.6 billion in 1996 and $9.7 billion over the next five years--compared with the 1995 funding level adjusted for inflation.

A number of arguments have been advanced for limiting U.S. support for the banks. Some critics charge that the banks have forgotten the first principle of sustainable development: the projects being funded must generate a positive return on the investment. Internal audits report that over a third of the World Bank's projects are unsatisfactory at completion and that nearly 40 percent of the countries borrowing from the bank have problems with more than a quarter of their projects. Critics claim those poor investments have contributed to the "debt overhang," or insolvency, of severely indebted low-income countries. In 1993, for example, the median share of long-term debt that such countries in Africa owed to the multilateral banks was 40 percent.

Critics claim that the multilateral banks are bloated bureaucracies that are more interested in approving and disbursing loans than in determining whether the loans are well invested. They argue that the banks have incentive systems that create a preoccupation with getting loans approved. Loan officers add features to their proposals that may enhance the

prospect of obtaining the board's approval but that complicate implementation and endanger the success of the projects being funded. They focus too much on project characteristics and too little on a country's ability and commitment to carry out the project. As a result, projects may be approved for countries that are not committed to their success; economic returns may therefore be lower than projected. Not increasing their resources would force the banks to pay more attention to the success of lending activities and efficient management.

Some critics also claim that the bank's lending harms the economies of developing countries. They believe that large amounts of aid could raise the recipient country's exchange rate and reduce the country's need to earn foreign exchange through exports. An overvalued exchange rate increases the relative costs of domestic products, thereby reducing their competitiveness in world markets. According to this argument, poor investments by the multilateral banks not only waste money but also drag down the entire economy of the recipient country. Other critics believe that the bank's lending policies create a bias toward government control of the economy. The banks lend primarily to or through governments, and critics argue that that promotes the growth of inefficient government sectors to the detriment of the private sector. In countries that do not have representative governments, the lending benefits the state or the people or parties that control the state rather than the population at large. The constant infusion of concessional lending weakens financial discipline, destroying the incentives that foster sound business practices.

Finally, environmental groups charge that the large-scale projects funded by the banks too often damage the environment and marginalize indigenous peoples. They point to examples such as the Polonoreste plan in northern Brazil, where new set-tlers have burned thousands of square miles of tropical forests to produce cropland, which is soon exhausted, and grazing land for large cattle ranchers. The banks have financed dams for irrigation in India that have displaced hundreds of thousands of poor farmers and tribal peoples without improving their standard of living. The dams have inundated entire ecosystems.

Supporters of the banks would argue that the banks are the most effective instrument in promoting policy reform in developing countries and in countries undergoing the transformation to democracies with a free-market orientation. The banks promote U.S. interests around the world on a scale that the United States, acting alone, could not afford. For example, the banks have undertaken important initiatives such as promoting reform in Eastern Europe and the republics of the former Soviet Union, reducing poverty in Africa and Asia, and fostering development in the West Bank and Gaza. If the United States stopped contributing to the banks, its ability to shape their policies and operations would be weakened. Supporters would also note that the harmful effects on indigenous populations, the environment, and the economy were common to all past development efforts, not just the banks' projects.

The banks' advocates might also point out that developing countries are the most rapidly expanding export market and that the financing the banks provide is a particularly important source of support in expanding U.S. exports to those countries. They might argue further that the poor performance of the banks' portfolios is exaggerated: development is a risky business, and if the banks were making only safe loans, they would not be serving their main function of taking risks that profit-oriented investors shun.

DEF-37 ELIMINATE OVERSEAS BROADCASTING AND REDUCE EXCHANGE PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	145	255	620	685	685	2,390
Outlays	-100[a]	195	570	675	685	2,025
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	165	305	695	790	820	2,775
Outlays	-15[a]	270	640	770	805	2,470

a. Because of termination costs, no savings are realized until 1997.

U.S. overseas broadcasting is provided by several entities. Radio Free Europe (RFE) and Radio Liberty (RL) broadcast country-specific news to Eastern Europe and the former Soviet Union, respectively. The Voice of America (VOA) oversees radio broadcasts that provide news and U.S.-related information to audiences worldwide. In 1994, the Congress consolidated appropriations for RFE/RL and VOA, though they remain separate entities.

The United States Information Agency (USIA) oversees television broadcasting services similar to the radio broadcasts of VOA and also manages a broadcasting service to Cuba. In addition, the USIA administers educational and cultural exchange programs, in which U.S. citizens travel to foreign countries and foreign citizens come to the United States to learn about the other country's institutions and culture.

This option would eliminate VOA and RFE/RL, end broadcasting services to Cuba, and reduce funding for exchange programs by 30 percent. Such reductions in exchange programs would eliminate all real growth that occurred between 1991 and 1995. The option would also end all overseas construction of broadcast facilities and would end U.S. overseas television broadcasting. When measured against the 1995 funding level, five-year savings would total nearly $2.4 billion. Closing RFE/RL and VOA, which have a combined operating budget of $470 million, would cost about $155 million in 1996 but would yield five-year savings of about $1.2 billion. Over the five-year period, ending broadcasts to Cuba would save about $105 million; terminating construction of broadcast facilities, $560 million; and stopping U.S.-sponsored television broadcasts, about $105 million. Near-term savings for those programs would be reduced by large termination costs, such as severance pay for employees. The 30 percent reduction in funding for exchange programs would save an additional $460 million in 1996 through 2000. Compared with the 1995 funding level adjusted for inflation, this option would save approximately $2.8 billion over the five-year period.

Proponents of terminating overseas broadcasting claim that RFE/RL and VOA are relics of the Cold War that are no longer necessary. RFE and RL continue to broadcast to countries of Eastern Europe and the former Soviet Union even though, after the fall of communism, those countries have ready access to world news. With the advent of satellite television broadcasting, most nations can receive world and U.S.-related news from private broadcasters, such as the Cable News Network (CNN). Some proponents also argue that the primary technology used by VOA and RFE/RL limits the effectiveness of U.S. overseas broadcasting; because shortwave radios are needed to receive most broadcasts, audiences are limited. Fi-

nally, foreigners may distrust the accuracy of broadcasts sponsored by the U.S. government.

Critics of this option would argue that the current level of broadcasting should continue or even increase. The process of change in Eastern Europe and the former Soviet Union needs nurturing, and U.S. broadcasting can assist in that process. In other parts of the world, many countries remain closed. Supporters of VOA and RFE/RL argue that shortwave radio broadcasts are the best way to reach people in closed countries because very few people own satellite dishes, which are needed to receive television broadcasts such as those by CNN. They note that VOA and RFE/RL are continuing to broadcast more programs over AM and FM frequencies. Supporters also argue that broadcasting should be sharply increased to some countries, such as China and North Korea. Further, they believe that television is a powerful communications tool and that private television networks cannot adequately communicate U.S. policy and viewpoints.

Funding for U.S.-sponsored exchange programs has grown by about 35 percent in real terms between 1991 and 1995. Critics of the programs argue that some of this growth may have been unnecessary because as increased communication and private travel make the world a smaller place, the need for exchanges decreases.

Advocates of exchange programs believe that exchanges provide participants with a unique perspective and an in-depth knowledge of foreign cultures and institutions. They argue that as the United States continues to build stronger economic and political ties with foreign countries, this knowledge is invaluable, and funding for exchange programs should therefore be increased, not decreased.

DEF-38 REDUCE EXIMBANK'S CREDIT ASSISTANCE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	287	287	287	287	287	1,433
Outlays	30	99	164	215	235	744
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	313	340	370	400	431	1,854
Outlays	33	111	192	264	307	908

The Export-Import Bank (Eximbank) promotes U.S. exports by providing subsidized financing to foreign buyers of U.S. goods. The bank makes direct loans with below-market interest rates and provides guarantees of private lending without receiving full compensation for the contingent liability of future losses. The U.S. exporter and the foreign buyer share those subsidies. In the 60 years since its creation, Eximbank has lost $8 billion on its operations, practically all in the past 15 years. New subsidy costs for Eximbank are estimated to be about $0.8 billion a year.

This option would cut the subsidy appropriation by one-third, to $500 million a year, saving $287 million in 1996 and $1.4 billion through 2000 compared with the 1995 funding level. The option would save $313 million in 1996 and $1.9 billion over the next five years compared with the 1995 funding level adjusted for inflation. To ease the impact that reduced funding would have on exports, the bank could raise risk-related fees and ration its budgetary resources to sales that would not go forward without government-assisted financing.

Eximbank's credit assistance is driven by demand. The bank provides assistance on a first-come, first-served basis and tries to meet all requests. Supporters of Eximbank call for ever-larger funding levels to meet exporters' desires for subsidized credits. But U.S. exports are not increased if the bank's credit is substituting for private-sector financing. The bank could avoid such substitution by targeting regions that are underserved by private-sector financing.

Supporters of Eximbank say that the subsidies it provides offset those provided by foreign governments and that cutting the subsidies would put U.S. exporters at a disadvantage. They would argue that in 1994 the bank raised fees on most of its lending, including a doubling of fees on aircraft exports. The cuts in this option would force the bank to reduce funding for $2 billion to $7 billion worth of exports, thereby providing fewer jobs to U.S. workers. Supporters of the bank argue that it should be driven by demand, letting market forces determine export sales rather than having the bank target which sales to finance. Reducing the subsidy would limit the bank's exposure in high-risk markets, the very markets in which private-sector financing is most difficult to obtain. The bank also plays an important role in encouraging the participation of small businesses in export markets. Finally, supporters claim that the bank's subsidies help to increase the output of high-technology industries and allow them to achieve economies of scale.

Critics of Eximbank dispute these claims. The bank, they point out, extends credit assistance to parties other than exporters facing foreign-subsidized competition. The bank's new fee structure is still among the lowest of any major exporting country. And little evidence exists that the credits create jobs. Finally, since the United States encourages the creation of free-market economies throughout the world, providing subsidies to promote exports is contrary to the free-market policies the United States advocates.

DEF-39 REDUCE STATE DEPARTMENT FUNDING AND ELIMINATE MISCELLANEOUS FOREIGN AFFAIRS ACTIVITIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	85	115	150	180	180	710
Outlays	75	105	135	165	170	650
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	165	280	390	510	605	1,950
Outlays	135	240	345	460	560	1,740

The Department of State, which employs about 25,000 full-time personnel in the United States and in foreign countries, promotes U.S. foreign policy interests abroad. Other, smaller agencies also conduct research and activities relating to foreign affairs.

The State Department will receive about $2.6 billion in 1995 to administer its foreign affairs programs. In the early 1980s, that portion of the State Department's budget was approximately $1.7 billion. Inflation was responsible for some of the increase, but the funding that was added to provide security for diplomats and to establish new posts in the republics of the former Soviet Union also contributed. Even when funding for added security and new posts is excluded, however, real growth from the 1980s through 1995 amounts to about 10 percent. The increases in funding mainly reflect growth in salaries and related expenses and in rental and acquisition costs of residences and office space.

The State Department is not the only federally funded organization that works on foreign affairs activities. Smaller agencies such as the U.S. Institute of Peace, the Asia Foundation, the East/West Center, and the North/South Center perform functions that could be eliminated without directly affecting U.S. foreign policy. Those agencies, which have combined budgets totaling about $60 million annually, conduct research and work to build better relations between the United States and various foreign countries.

This option would reduce State Department funding from 1996 through 1999 by phasing in nominal cuts in appropriations. By 1999, State Department funding (excluding the cost of security improvements and new posts in the former Soviet Union) would return to its real level of the early 1980s. Compared with the 1995 funding level, this option would save $710 million over the 1996-2000 period--$430 million by reducing State Department funding and $275 million by eliminating the related functions of various other agencies dealing in foreign affairs. Compared with the 1995 funding level adjusted for inflation, this option would save about $2 billion over the five-year period.

The department could accommodate these cuts by readdressing its mission and implementing a policy of comprehensive change. Some of those changes might include eliminating or consolidating posts in less important areas of the world, reorganizing the State Department's bureaucracy, and reducing the number of senior foreign service officers, which some studies have suggested is too high given the size of the foreign service.

The State Department's Office of the Inspector General (OIG) has outlined several specific recommendations for achieving savings. An OIG audit of the Diplomatic Security Field Office Operations indicated that the efficiency of that office could be improved by more carefully screening passport fraud cases, eliminating approximately 100 special agent

positions at field and resident offices, and ending nonessential security services. In addition, changing overseas allowance rates could yield savings of nearly $10 million a year. These changes would make the State Department more efficient and able to operate at this lower funding level.

Opponents of this option would argue that more money--not less--will be needed to handle the new, complex issues that the United States now faces abroad. The current number of senior foreign service officers may be needed to represent the United States in the post-Cold War world in which economic superpowers will compete. Finally, the smaller agencies dealing in foreign affairs might be viewed as providing valuable independent analysis of issues and improving the United States' understanding of, or relations with, foreign countries.

DEF-40 REDUCE DEVELOPMENT ASSISTANCE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	800	990	1,190	1,390	1,620	5,990
Outlays	80	530	780	970	1,160	3,520
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	890	1,160	1,460	1,750	2,080	7,340
Outlays	100	610	930	1,200	1,480	4,320

The Agency for International Development (AID) administers development-related projects and provides technical advice in 109 developing countries and emerging democracies. Since the creation of AID in 1961, the United States has spent $126 billion on development assistance. AID and its programs have been criticized, however, for waste and ineffectiveness. This option would markedly scale back AID and the programs it administers, thereby allowing the agency to focus on more attainable goals in countries that are most likely to benefit from U.S. development assistance. Reducing development assistance along the lines suggested below would save $800 million in 1996 and $6 billion over the five-year period compared with the 1995 funding level. Relative to the 1995 level adjusted for inflation, savings would be $890 million in 1996 and $7.3 billion over five years.

Two decades ago, the last major revision of the Foreign Assistance Act directed AID to focus on four objectives: alleviating poverty, fostering economic growth, encouraging respect for civil and economic rights, and integrating developing countries into an international economic system. Since then, the Congress has added more than 30 new objectives that range from promoting biodiversity to reducing urban pollution. Reports issued by AID, as well as by the Congress and independent commissions, have stated that the agency has too many objectives and supports projects in too many countries. Those reports recommend that AID narrow its focus and fund fewer projects with more attainable goals.

Some critics of assistance offer an even harsher assessment. They contend that even if U.S. development assistance programs were properly managed and targeted, the resulting improvement in economic development would be marginal. Those critics argue that countries whose economies have grown steadily have typically not achieved that growth through the use of foreign assistance but by adopting economic policies that promote free markets and trade. Furthermore, some analysts contend that because the performance of the U.S. economy affects the economies of developing countries, a healthy U.S. economy is the best type of development assistance the United States can provide. With a healthy economy, U.S. consumers will buy more imports from developing countries, thereby creating wealth and promoting markets and trade in those countries.

The option would phase in spending reductions over the next five years. Development assistance grants would be cut by one-third from the level provided in 1995. Faced with a reduction of that size, the Administration would probably triage its development assistance programs--eliminating assistance to some middle-income countries no longer in need of U.S. assistance and terminating assistance in countries in which U.S. assistance has shown no results. The estimate assumes that the Administration would close between 15 and 20 overseas missions from 1996 through 1998, thereby saving administrative expenses; it also includes the Administration's 1995 funding reductions planned for Eastern Europe and the new states of the former Soviet Union.

In addition, this option would eliminate the housing investment guarantee program, which arguably is inconsistent with other U.S. objectives. The program provides high-interest, hard-currency loans to developing countries for housing. A decade after the recognition of the international debt crisis, that form of U.S. assistance is not helping recipient countries, because housing is an activity that does not generate the foreign exchange those countries need to retire their debt.

Opponents of these reductions would argue that AID has technical expertise that the developing world finds valuable. Despite the mixed success of AID projects, its supporters contend that the United States should continue to fund development assistance programs in a large number of countries because many problems that developing countries face cannot be solved by the free market alone. Such problems as environmental pollution, the spread of the acquired immunodeficiency syndrome, and immigration and refugee problems are international in scope and thus affect the United States. Opponents of cutting development assistance might argue that such aid is a foreign policy tool that can help solve those problems and ultimately help the United States itself. Finally, U.S. aid might be justified on purely humanitarian grounds.

DEF-41 ELIMINATE P.L. 480 TITLE I SALES AND TITLE III GRANTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	0	430	430	430	430	1,720
Outlays	0	240	410	430	430	1,510
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	0	460	470	490	500	1,920
Outlays	0	250	440	480	500	1,670

The Agricultural Trade Development and Assistance Act of 1954 (Public Law 480) was enacted during a period when the inconvertibility of foreign currencies and the lack of foreign exchange held by potential customers limited commercial exports of large domestic surpluses of agricultural commodities. Sales for foreign currencies, concessional credit, and grants provided a mechanism for developing markets, disposing of surplus commodities, and furthering U.S. foreign policy interests.

Changes in the world over the past 40 years may have rendered the program obsolete, however, and it may now be an inefficient means of achieving each of those objectives. This option would eliminate sales under title I of the act and grants under title III beginning in 1997. That would reduce the federal budget by $430 million in 1997 and $1.7 billion through 2000 relative to the 1995 funding level. Savings would be $460 million in 1997 and $1.9 billion through 2000 relative to the 1995 funding level adjusted for inflation. Humanitarian and emergency feeding programs are funded under title II of P.L. 480 and under section 416 of the Agricultural Act of 1949 and would not be affected by this option.

The market development aspect of the P.L. 480 program is relatively insignificant for two reasons: exports under titles I and III are a small portion of total U.S. agricultural exports, and the countries currently receiving P.L. 480 commodities are unlikely to become commercial customers. In 1956 through 1965, the P.L. 480 program financed between one-quarter and one-third of all agricultural exports. Since the mid-1960s, the value and tonnage of shipments under titles I and III have declined as commercial exports have grown. In 1993, those shipments represented less than 2 percent of the $43 billion in total agricultural exports. U.S. security or foreign policy interests largely determine which countries receive commodities under titles I and III. If market development remains an objective of U.S. policy, it should focus on countries that are likely to become commercial customers in the near term. Other programs such as the Commodity Credit Corporation's short- and intermediate-term credits and the Export Enhancement Program are designed to protect old markets and to penetrate new markets at lower cost to the U.S. government.

Disposing of surpluses is no longer a primary concern of the program. The government no longer holds stocks of most of the commodities shipped under P.L. 480; they are managed instead through the Acreage Reduction Program. The option would terminate title I and title III shipments after the 1996 crop year. The delay would permit the Department of Agriculture to lower production through an increased acreage set-aside in 1996, which would not build surpluses or affect the budget.

Providing assistance to developing countries through P.L. 480 is not always an efficient use of U.S. resources. Many of the U.S. agricultural commodities that foreign countries buy with P.L. 480 assistance are resold to generate local currency.

Those funds are used in turn to support local budgets and local development. But the inexpensive food may discourage local investment in agriculture, may lower rural employment and income, and may discourage the development of local stockpiles. To the extent that one or more of those effects occurs, the United States has hindered local development.

In some cases, the terms of credit granted under title I may actually harm the economies of the countries that receive the credits. Those credits have maturities as long as 30 years, and thus the obligation for repayment remains long after the item purchased has been consumed.

These drawbacks notwithstanding, titles I and III of P.L. 480 also have their supporters who argue that the programs are a flexible, fast means of providing assistance to friendly countries. They also point out that the programs reduce the likelihood that surpluses of agricultural commodities will depress prices within the United States and that they offer some humanitarian benefits: agricultural products are shipped, and hungry people are fed.

Chapter Three

Domestic Discretionary Spending

Domestic discretionary programs include all federal programs funded through appropriations except those in defense and international affairs. An extremely varied category results, comprising the areas of science and space, transportation, energy, agriculture, environmental protection, housing, education and training, medical research, and law enforcement (see Box 3-1). The agencies that receive significant funding from domestic discretionary appropriations are among the most visible in government; they include the Departments of Agriculture, Education, Energy, Health and Human Services, Housing and Urban Development, and Justice, as well as the Environmental Protection Agency and the National Aeronautics and Space Administration. Many of the programs and activities funded under the domestic discretionary category are also prominent and, in many cases, popular. Some examples are the space station and space shuttle, Superfund, support for U.S. farm exports, small business loans, aid to Amtrak and mass transit, support for elementary and secondary education, the National Cancer Institute, and various programs to control illegal drugs.

Spending for domestic discretionary programs in 1995 will reach an estimated $253.2 billion, or about 17 percent of federal outlays. Spending for four budget functions--transportation (400), health (550), income security (600), and education, training, employment, and social services (500)--will account for about half of the total (see Table 3-1). Cutting across budget functions, pay for the federal workforce will make up about 25 percent of total discretionary spending for domestic programs, and aid to state and local governments will account for 35 percent of the total.

The 1995 level of spending for domestic discretionary programs represents a $10.8 billion--or 4.5 percent--increase over spending for the same purposes in 1994. That increase was sufficient to continue the mild upward trend evident since the late 1980s in the percentage of gross domestic product (GDP) accounted for by discretionary spending for domestic programs (see Figure 3-1). The climb in spending for 1995 exceeded the rate of inflation and occurred at the same time that limits imposed on all spending by the Budget Enforcement Act of 1990 and continued under the Omnibus Budget Reconciliation Act of 1993 reduced total discretionary spending (a larger grouping that includes spending for discretionary defense and international programs). Such spending fell by $1 billion--from $545 billion in 1994 to $544 billion in 1995. During 1995, increases in spending for domestic discretionary programs were accommodated within the overall spending limits for discretionary programs by decreasing discretionary spending for defense.

The outcome for 1996 is likely to be different. The spending limits established by law for 1996 permit only an $8 billion (less than 2 percent) increase in all discretionary spending. CBO estimates that a $9 billion increase would be necessary in 1996 just to maintain the 1995 funding level in the domestic discretionary category after adjusting for inflation. Moreover, the priorities of the new Congress are different from those of its predecessor. The Contract with America, for example, supported by the Republican majority in the House of Representatives, calls for simultaneously cutting taxes, increasing defense spending, and moving toward a balanced budget. To achieve those goals, reductions would be necessary

Box 3-1. Categories of Domestic Discretionary Spending

250 General Science, Space, and Technology--Research supported by the National Science Foundation, the bulk of the spending by the National Aeronautics and Space Administration, and the general science research supported by the Department of Energy.

270 Energy--Domestic energy programs of the Department of Energy and activities of the Rural Electrification Administration and the Nuclear Regulatory Commission, including programs to increase the supply of energy, encourage energy conservation, provide an emergency stockpile of energy, and regulate energy production.

300 Natural Resources and Environment--Programs administered by the Army Corps of Engineers, the Department of Agriculture, the Department of the Interior, the Environmental Protection Agency, and the Department of Commerce's National Oceanic and Atmospheric Administration, among others, for water resources, conservation and land management, pollution control, and other natural resources programs.

350 Agriculture--Programs administered by the Department of Agriculture to promote economic stability in agriculture and increase agricultural output. Farm income stabilization--loans, subsidies, and other payments to farmers--and agricultural research are funded under this function.

370 Commerce and Housing Credit--Funding for the regulation and promotion of commerce and the housing credit and deposit insurance industries. Also included in this category are subsidies to the Postal Service, programs providing loans and other aid to small businesses, and support for the government's efforts to gather and disseminate economic and demographic data.

400 Transportation--Most of the programs of the Department of Transportation and the National Aeronautics and Space Administration's support for aeronautical research, including funding to aid and regulate ground, air, and water transportation. Among the prominent programs supported under this function are grants to states for highways and airports and federal subsidies to Amtrak.

450 Community and Regional Development--Programs that support the development of physical and financial infrastructure intended to promote viable community economies, including activities of the Department of Commerce and the Department of Housing and Urban Development. This function also includes expenditures to help communities and families recover from natural disasters and supports the rural development activities of the Department of Agriculture, the Bureau of Indian Affairs, and other agencies.

500 Education, Training, Employment, and Social Services--Funding for a diverse group of education and training programs extending from the preschool level (the Head Start program, for example) to elementary and secondary education (grants to states, for instance) to postsecondary education and vocational training. Most of the programs included in this category are administered by the Departments of Labor and Education.

550 Health--Research (in the form of grants, largely to universities) supported by the Department of Health and Human Services through the National Institutes of Health, and programs funded by several different federal agencies to promote food and drug safety, consumer product safety, and occupational safety.

570 Medicare--The administrative expenses of the program, which are classified as discretionary. (Medicare provides health care services to people age 65 and older and to disabled beneficiaries.)

600 Income Security--Housing assistance, administered by the Department of Housing and Urban Development, and other major discretionary programs including assistance to needy individuals for food and energy.

700 Veterans Benefits and Services--Funding for veterans' hospitals and the construction of veterans' health facilities.

750 Administration of Justice--Programs that provide judicial services, law enforcement, and prison operation. The Federal Bureau of Investigation, the Customs Service, the Drug Enforcement Administration, and the federal court system are all supported under this function.

800 General Government--Funding for the central management and policy responsibilities of both the legislative and executive branches of the federal government. The bulk of the expenditures in this category cover legislative functions and central fiscal operations, including those of the General Services Administration and the Internal Revenue Service.

SOURCE: General Accounting Office, *A Glossary of Terms Used in the Federal Budget Process* (January 1993), pp. 103-126.

in discretionary spending for domestic programs and in entitlements. The Administration is also offering proposals to reduce domestic discretionary spending as a source of savings to offset a proposed set of tax cuts. Accordingly, the competition for limited funds that was evident in 1995 is likely to intensify in 1996, bringing to the fore the spending reduction options that make up this volume.

Other Pressures

From a big-picture perspective, the simple arithmetic of the budget places cuts in spending for the agencies and programs included in the domestic discretionary category "on the table" in efforts to trim the federal deficit. In addition, the movement to reduce the size and scope of government, and the related effort to reinvent it, in many cases--although not always--apply complementary pressure for reducing domestic discretionary spending. The possibilities of turning to the private sector for services currently provided by the federal government and of selling assets that the government owns are related themes that also have implications for such spending.

The announced intention of many members of the new Congress to reduce the size and scope of government, and the Administration's now two-year-old reinventing government initiative, require federal agencies both to change the way they do business and, in some instances, to shed parts of their current mission. Some proposals consistent with those themes would lead to deficit reduction; others would not. A government that did less and thereby cost

Table 3-1.
Budget Authority and Outlays for Domestic Discretionary Programs, by Budget Function, 1995
(In billions of dollars)

Budget Function	Budget Authority	Outlays
General Science, Space, and Technology (250)	17.5	17.3
Energy (270)	6.3	6.6
Natural Resources and Environment (300)	21.9	21.5
Agriculture (350)	4.0	4.2
Commerce and Housing Credit (370)	3.0	3.0
Transportation (400)	15.0	38.4
Community and Regional Development (450)	8.6	9.0
Education, Training, Employment, and Social Services (500)	42.0	39.3
Health (550)	22.8	22.3
Medicare (570)	3.0	3.0
Income Security (600)	34.0	38.9
Social Security (650)	0	2.5
Veterans Benefits and Services (700)	18.3	18.3
Administration of Justice (750)	18.1	16.7
General Government (800)	12.1	12.1
Total	226.8	253.2

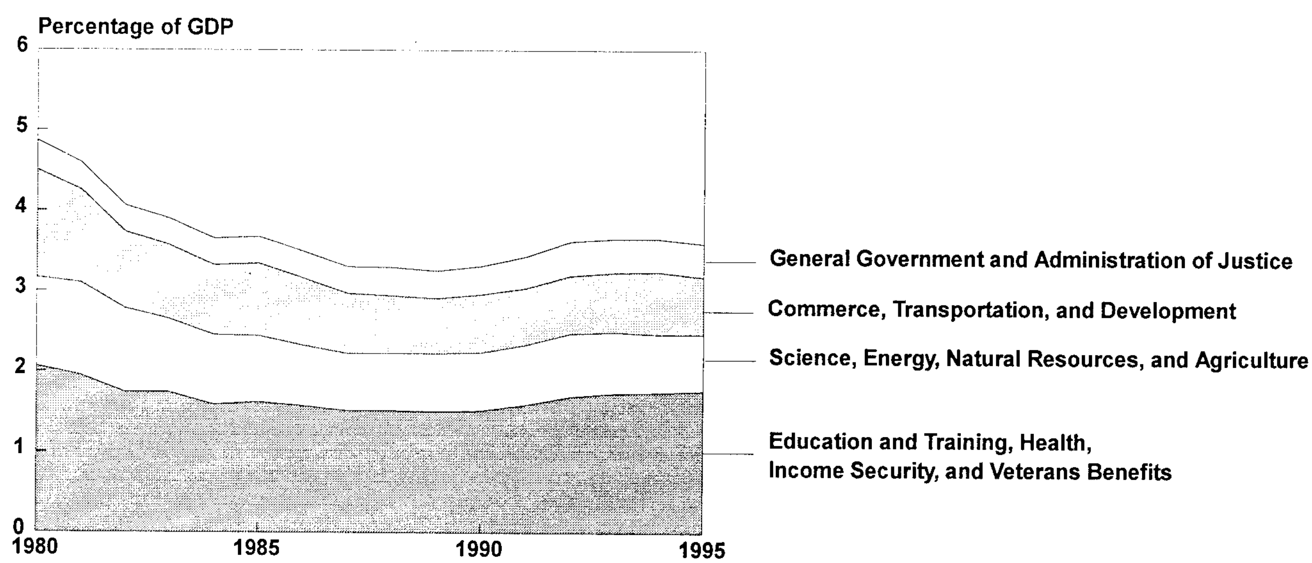
SOURCE: Congressional Budget Office.

less would not lead to a lower deficit were revenues to fall more steeply than spending. A government that was more efficient might deliver more benefits for a given level of expenditures, yet leave the deficit unchanged. Eliminating a major department by moving its programs intact to other departments would not substantially decrease federal spending. Substituting block grants for directed spending programs would reduce outlays only if the total funds allocated to grants were less than what would have been spent in the directed spending program. Moreover, the experience of the private sector in "downsizing" indicates that success may be preceded by costly investments to determine how best to economize.

In some cases, proposals have been offered to eliminate entire agencies (for example, the Department of Energy) or to banish the federal government from areas in which it has long participated (for example, elementary and secondary education). Although this volume does not include an option that eliminates a large government department, many of the alternatives it presents call for substantial curtailment of federal activity and spending in specific areas. Furthermore, in some cases, the budgetary result of eliminating an agency would be approximated by combining options from this chapter that reduce spending with options from the next chapter that increase the fees charged to users of services provided by the federal government. For example, if existing excise taxes are left in place, a substantial part of the potential to reduce the deficit that would come from privatizing some or all of the Federal Aviation Administration lies in reducing subsidies for air travel--which is the essence of DOM-24 and DOM-25 eliminating airport grants-in-aid and the Essential Air Service program, respectively--and in increasing fees, as in ENT-20 for air traffic control and ENT-24 for services provided to general aviation.

Selling assets owned by the federal government relates to both reducing the deficit and asking fundamental questions about the size and scope of government. The Administration has proposed asset sales that include several power marketing associations and the naval petroleum reserves. Current Congressional scorekeeping rules do not permit the proceeds from an asset sale to count directly toward satisfying the statutory limits on discretionary spending. Un-

Figure 3-1.
Domestic Discretionary Spending as a Share of GDP



SOURCE: Congressional Budget Office.

derlying those rules is the idea that an asset sale leaves the financial position of the government unchanged because the current inflow of dollars is offset by a future loss--the discounted value of lost future receipts or added future costs. Accordingly, this volume does not include most of the major proposed asset sales. Some of those sales, however, in conjunction with "privatization," would lead to less federal spending in cases in which direct appropriations are required to cover the operational cost of employing the asset to deliver a specific good or service. Selling the Strategic Petroleum Reserve (see DOM-07) is included as an option in this year's volume under that reasoning.

Rationales For and Against Spending Reductions

Discussions this year of how to reduce federal spending for domestic discretionary programs seem more intense than in past years, as proposals to eliminate agencies, entire programs, and the federal role in some areas of activity are more prominent than those calling for incremental decreases in funding for selected programs. But the aggressiveness of some current proposals should not obscure the constancy over the years in the general rationales offered in support of reductions in discretionary spending for domestic programs, nor in the arguments that call for maintaining current programs and spending.

Three general rationales for cutting federal spending on domestic discretionary programs stand out in the present environment. First, federal outlays could be reduced when programs are found to be ineffective or inefficient in meeting their objectives. For instance, the argument that past spending has been ineffective in achieving program goals is offered in support of DOM-55, an option that would reduce expenditures by closing or converting inefficient or underused facilities in veterans' hospitals. Second, federal spending could be scaled back for programs that arguably have outlived their usefulness, a point made in the case for eliminating the credit subsidies provided by the Rural Utilities Service (see DOM-09). Third, federal spending could be pared down by eliminating programs that benefit local areas, industries, firms, or groups of consumers but that do not deliver benefits beyond the directly affected group. The argument for DOM-25, an option to end the Essential Air Service program, is an example of that position, pointing out that programs that generate primarily local benefits ought to be locally funded. DOM-30, an option to eliminate applied research and development support for the producers of commercial aircraft, illustrates the case to be made for cutting a program when the federal government pays for research that produces benefits that could, for the most part, be captured by directly affected private businesses making comparable investments.

At the heart of the third major rationale supporting many options that would reduce domestic discretionary spending is a negative answer to the question, "Is this an appropriate activity for the federal government?" As such, that long-standing basis for eliminating a federal activity and reducing spending joins with currently popular ideas about reinvention, privatization, or scaling back of the federal government. It is also the other side of the budgetary coin from the current discussion about federal laws that force states, localities, and private businesses to spend money to conform with federal mandates. The reexamination of federalism occurring in the discussions of unfunded mandates and their impact on the private sector would be incomplete if it did not consider the prospect of decreasing the flow of federal funds to programs and activities that deliver primarily local benefits or that produce benefits that could be secured by private investors pursuing the highest returns on their investments.

Balancing the general arguments for specific spending reductions are equally general defenses of current programs and spending. The supporters of activities that are criticized as outmoded, ineffective, or unlikely to produce benefits large enough to justify their costs sometimes simply reject those characterizations. (For example, advocates of continued spending for the international space station--discussed in DOM-01--argue that the benefits from the facility far exceed its costs.) In other cases, advocates of spending that directly benefits a specific area, group, or industry contend that the benefits also accrue indirectly to the nation at large. According to those proponents, spending that supports a specific

industry--for example, the research and development spending questioned in DOM-02, DOM-03, and DOM-64--may, from society's point of view, compensate for inadequate market signals that would lead private investors to invest too little in such activities. Similar claims of benefits beyond those granted to direct recipients of funds are offered in support of programs that raise health, education, or housing standards for a particular locality or group to meet a national goal. Reductions in those programs will generally fall most heavily on current recipients who have little or no ability to adjust--poor, elderly, or disabled people. In those cases, the appropriateness of the federal government's role is as likely to be offered as an argument for an expenditure as against it.

Process and Presentation

Because all of the options in this chapter would affect discretionary spending, achieving the budgetary savings they offer would require legislation in the form of appropriation acts. In some cases, however, the options describe changes in the laws authorizing the programs in addition to reductions in the amounts appropriated for them. Options that propose alterations in authorizing legislation would change the goals of a program or the methods of achieving them. An example of such an option is DOM-13, which would reduce the level of cleanup required in the Superfund program. The effect of the program change combined with reduced appropriations would be different from the effect of cuts in appropriations alone.

The text accompanying each option contains a description of the option's programmatic changes and their effects, and arguments for and against the changes. The estimated savings for most of the options to reduce discretionary spending for domestic programs are presented as reductions from both the 1995 funding level held constant from 1996 through 2000 and the 1995 funding level adjusted for inflation over the same period. Prominent exceptions are DOM-60 and DOM-61, which deal with personnel management. In those options, reductions are taken from projections that incorporate assumptions about expected employment levels and include scheduled adjustments for inflation, spelled out in the Federal Employees Pay Comparability Act of 1990. Other exceptions are noted in the individual options as necessary.

Estimates of savings from the 1995 funding level held constant from 1996 through 2000 are included in this year's volume in response to concerns expressed in the Congress about the usefulness of budget projections that have been adjusted for inflation. Critics point out that calculating spending reductions from such projections could lead to a claim of savings credited to a program that continues to enjoy increased funding in nominal terms. Conversely, a frozen baseline carries with it an appearance of maintaining the status quo when it is actually delivering less as prices rise. Programs in the domestic discretionary area would have to be adjusted, diminished, or made to work more efficiently to fit within constant funding at the 1995 level from 1996 through 2000. With discretionary spending for domestic programs frozen at the 1995 level through 2000, projections show that the real resources allocated for those purposes would decrease by about 14 percent. Even the most optimistic advocates of the power of budget tightening to induce gains in efficiency would be likely to concede that budgets frozen for an extended period of time ultimately buy less.

Care should be taken in constructing a deficit reduction plan to match estimates of savings with the correct corresponding overall budget projection--that is, the total projection for all spending figured from either the adjusted or unadjusted 1995 level. For example, subtracting savings calculated against an inflation-adjusted baseline from a projection of overall spending that freezes discretionary spending at the 1995 level would overstate the savings associated with the reduction because the frozen level has not taken inflation into account to begin with.

DOM-01 CANCEL THE INTERNATIONAL SPACE STATION PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	2,100	2,100	2,100	2,100	2,100	10,500
Outlays	1,323	1,953	2,100	2,100	2,100	9,576
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	2,169	2,243	2,323	2,402	2,486	11,623
Outlays	1,367	2,064	2,288	2,367	2,450	10,536

Canceling the international space station program would reduce outlays by $1.3 billion in 1996 and by $9.6 billion over the 1996-2000 period measured against the 1995 funding level. Measured against the 1995 funding level adjusted for inflation, savings would be $1.4 billion in 1996 and $10.5 billion from 1996 through 2000.

During 1994, the space station program achieved a degree of stability compared with the upheavals of 1993. The program's cost, content, and schedule are now all more certain than in the past. The National Aeronautics and Space Administration (NASA) and the Boeing Corporation, the space station's prime contractor, have signed a contract after lengthy negotiations. Russia has assumed a major role in the program, and agreements defining ownership, rights, and responsibilities are being finalized between the United States, Canada, European participants, Japan, and Russia.

Significant progress toward the launch, deployment, and operation of the space station weakens the argument for cancellation that emphasizes the uncertainty and unpredictability that have at times characterized the effort. But fundamental arguments against retaining the program are unchanged. NASA's progress toward completion and its sunk costs of $13 billion notwithstanding, the opponents of continuing the program question whether its future benefits are sufficiently large to justify the cost of completing and operating the facility.

In support of their position, critics cite the general lack of enthusiasm for the space station among individual scientists and scientific societies. The program's opponents also note that the cost of the program has continually increased, although its capabilities and scope of activities have decreased. Finally, critics point to the uncertainty surrounding the costs of operating and supporting the facility once it has been developed and launched. On that score, opponents are skeptical of NASA's assurance that the station's operating costs will be low, noting that the agency made similar claims about the space shuttle that proved overly optimistic.

Advocates of continued spending for the space station program emphasize the importance of its effects on employment in the aerospace industry at a time when declining defense budgets are reducing the demand for the industry's products and services. Supporters of the space station also argue that the participation of Russia has strengthened the foreign policy reason for continuing the program. They assert that drawing Russia, and particularly its aerospace industry, into a cooperative venture will help to stabilize the Russian economy and provide incentives for Russia to adhere to international agreements concerning the spread of missile technology. Supporters of the space station further note the long-standing arguments about the value of the project as a laboratory in orbit with unknown but positive scientific potential and as a test bed to learn how people in space live and work, in anticipation of future piloted explo-

ration of the solar system. Program advocates point out that the project's cancellation would force the United States to renege on agreements signed with European nations, Japan, and Canada. That withdrawal could hurt the prospects for future international cooperative agreements on space, science, and other areas of mutual interest.

DOM-02 SCALE BACK AND DELAY NASA'S EARTH OBSERVATION SYSTEM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	73	73	73	73	73	365
Outlays	39	68	73	73	73	326
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	75	78	81	83	86	403
Outlays	40	71	79	82	85	357
From the Administration's 1995 Plan						
Budget Authority	109	169	191	237	281	988
Outlays	58	133	176	214	257	839

The Earth Observation System (EOS) is the centerpiece of the National Aeronautics and Space Administration's (NASA's) participation in the multiagency Global Change Research Program. The current plan for EOS envisions many satellites launched over a number of years and a massive data information system. The first EOS satellite is scheduled for launch in the late 1990s. Scaling back and delaying parts of the system could reduce spending by $39 million in 1996 and by $326 million from 1996 through 2000 measured against the 1995 funding level, and by $40 million in 1996 and $357 million from 1996 through 2000 measured against the 1995 level adjusted for inflation.

The Administration's plan for NASA for the 1995-1999 period called for increasing the agency's budget at a rate just below that of inflation. Yet at that same time, the EOS budget was projected to almost double, from $740 million in 1995 to $1.2 billion in 1999. Compared with the Administration's plan for EOS, this option would generate savings of $839 million from 1996 through 2000, an amount significantly larger than the savings estimated against either the 1995 funding level or the 1995 funding level adjusted for inflation.

The purpose of the Global Change Research Program is to improve knowledge about the natural and anthropogenic processes and forces that influence global climate over the long term. Specifically, the program focuses on global warming, ozone depletion, changes in biodiversity, forest distribution, and desertification. EOS will be the primary eyes, ears, and nervous system of the program's efforts, gathering data by satellite and making those data available to researchers through a sophisticated information storage and retrieval system.

The EOS program has gone through several planning exercises that have reduced its scope and cost. When the program began in 1989, its design consisted primarily of two large spacecraft in polar orbit carrying 30 instruments at a projected cost of $17 billion through 2000. A 1992 restructuring plan reduced the cost of the program to about $11 billion by breaking up the large spacecraft, reducing the number of instruments, and stretching out the program's life. Another restructuring in 1993 further reduced the cost of the program to $8 billion for the 1990s. Marginal adjustments in 1994, known as a "rebaselining," decreased the estimated cost of the program to $7.2 billion.

This option lays out additional reductions in the EOS program. In particular, it would delay the third of the program's first three major satellites, the Chemistry-1, for five years from its scheduled launch in late 2002 and reduce funding for the EOS data information system (EOSDIS) by 25 percent from the levels in the current plan. Carrying out the option would delay the availability of the data that the Chemistry-1 satellite is designed to provide and limit the volume of and access to data that EOSDIS could offer. Other strategies for reducing spending could be substituted for the specific approach featured in this option. For example, the large multiple-instrument satellites included in the program's current plan could be broken down into smaller single-instrument satellites--which would delay observations and stretch out the program. Another budget reduction option would be to slow down production of all three of the program's larger satellites, AM and PM as well as Chemistry-1.

The primary argument for further reductions in spending for EOS holds that delaying the collection and analysis of EOS data will not substantially decrease the benefits that the program is designed to deliver. Scientists do not expect EOS to provide data and analysis to support environmental policy decisions over the next decade; rather, the focus of EOS's applied and basic science is on the longer term. Thus, the loss of benefits from deploying the Chemistry satellite in 2007 instead of in 2002 is arguably small. In a similar vein, reductions in spending for EOSDIS that limit access by researchers or slow the entry of new data may merely delay rather than deny the benefits produced by the project. A secondary argument is that EOS as currently planned does not take full advantage of evolving small-satellite technology or the prospect that private sources, if offered the proper incentives, could provide a larger part of the data that EOS is meant to obtain.

The case for continuing with the current program plan and budget holds that EOS has been repeatedly examined and that the present program constitutes the minimum acceptable effort. Moreover, although scaling back and stretching out the project would decrease spending in the next five years, the total cost of the program would be likely to increase. In addition, because EOS is integrated with the global change research programs of other nations, adopting this option (or virtually any other that would noticeably decrease spending) could well force international commitments to be renegotiated and might call into question the reliability of the United States as a partner in large-scale scientific ventures.

DOM-03 REDUCE DEPARTMENT OF ENERGY FUNDING FOR ENERGY TECHNOLOGY DEVELOPMENT EFFORTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Reduce Fossil Energy R&D						
From the 1995 Funding Level						
Budget Authority	66	133	199	266	332	996
Outlays	27	80	146	239	279	771
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	82	164	247	331	415	1,239
Outlays	33	98	181	297	348	957
Reduce Nuclear Energy R&D						
From the 1995 Funding Level						
Budget Authority	30	61	91	122	152	456
Outlays	14	38	69	108	129	358
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	37	75	113	151	190	566
Outlays	17	47	85	134	161	444
Reduce Fusion R&D						
From the 1995 Funding Level						
Budget Authority	56	112	168	224	279	839
Outlays	25	70	126	198	238	657
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	68	137	207	278	349	1,039
Outlays	31	86	155	246	295	813
Reduce Energy Conservation and Solar and Renewable Energy R&D						
From the 1995 Funding Level						
Budget Authority	83	165	248	331	414	1,241
Outlays	28	94	174	306	339	941
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	111	223	336	451	567	1,688
Outlays	37	126	235	414	462	1,274
Total, All Programs						
From the 1995 Funding Level						
Budget Authority	235	471	706	942	1,177	3,532
Outlays	93	281	514	851	985	2,723
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	298	599	904	1,211	1,521	4,532
Outlays	117	356	655	1,090	1,267	3,485

The Department of Energy (DOE) and its predecessors have been funding technology development projects for several different sources of energy since the first oil crisis in 1973. Since 1978, DOE has spent more than $30 billion to develop new energy sources. Given the magnitude of that investment, many lawmakers have questioned the value to the economy of those research and development (R&D) programs. To reduce spending, DOE could cut back on programs for near-term development of energy technologies and instead concentrate its efforts on basic and applied science in those fields.

Spending for new energy technologies can be reduced in a number of ways; the table on the previous page presents the savings associated with four such choices. The estimates assume that funding for the fossil, nuclear, and fusion energy R&D programs would be reduced to 25 percent of its 1995 level and that the reductions would be phased in over the 1996-2000 period. In the case of energy conservation and solar and renewable energy R&D, funding would be gradually reduced over the five years to 50 percent of its 1995 level. In total, those reductions would save $93 million in outlays in 1996 and $2.7 billion over the 1996-2000 period relative to 1995 funding levels. Should the options presented here all be implemented, they would save $117 million in 1996 and $3.5 billion in the 1996-2000 period relative to the 1995 funding level adjusted for inflation. (The two sets of estimates of savings differ because program services would have to be cut to maintain the programs at the 1995 funding level. Both sets of cuts would reduce the programs to the same level of funding in 2000. Reducing energy conservation and solar and renewable energy R&D by a smaller percentage is partly to compensate for the wide array of technologies involved in that option.)

The justification for adopting each of these options rests primarily on the appropriate division of labor between federal programs and related activities in the private sector. In many instances, embarking on large-scale technology development projects may be premature; supporting basic and applied science projects instead would allow a better understanding of the phenomena at issue before trying to harness them to a technology. In several areas, DOE has a comparative advantage in developing the basic and applied science around a new energy source but is at a comparative disadvantage in the costly technology development and demonstration phases. Federal agencies typically lack the sensitivity to see when a new technology is too expensive (or esoteric) for commercial purposes.

Arguments have been advanced to support each of the reduction options. In the area of fossil energy R&D, the first option in the table, commercial firms already spend a great deal of money to develop new technologies. The major new technologies for enhanced oil recovery, for example, have come from private industry, not DOE. In other instances, DOE continues to develop technologies in which the market clearly has no interest. As an illustration, DOE spent hundreds of millions of dollars on coal-powered magnetohydrodynamics--without any indication of interest in the product. (This option does not include the Clean Coal Technology Program, which is covered separately in DOM-04.)

For the second option, which involves nuclear energy R&D, the wisdom of pursuing new technologies is questionable as long as electric utilities, the intended recipients, have no interest in new nuclear plants. Construction of the last nuclear power plant still on order was canceled in 1994. (This lack of interest among utilities may rest in part on the fact that national policy for addressing nuclear wastes remains undeveloped.) DOE has spent $9 billion on nuclear fission R&D since 1978 and has little in the way of commercial applications to show for its investment. Moreover, policymakers recently began to open the electricity generation market by obliging utilities to buy electricity from a group of suppliers. Given those circumstances, it may be time to let the newly opened market encourage the private sector to develop its own technology. (The estimate of savings for this option excludes the already scheduled termination of existing research facilities and of the operations of the isotope production fund. Neither involves technology development.)

The third option deals with magnetic fusion R&D whose commercial markets may be decades away and for which large-scale technology demonstration projects may be premature. One reason is that the scientific phenomenon is not completely understood.

Critics of this program also charge that only one main approach to fusion is being considered, which increases the riskiness of the program.

Reducing funding for energy conservation and solar and renewable energy R&D, the fourth option, would affect many projects that are small and discrete enough--and in many cases have a clear enough market--to warrant private investment. In such instances, DOE may be crowding out private-sector firms or, alternatively, conducting R&D that those private sectors are likely to ignore--a common fate of the technology generated within DOE's national laboratories. Furthermore, spending for energy conservation and solar and renewable energy R&D has almost tripled since 1990. (Funds for energy conservation R&D are distinct from technical and financial assistance programs, which would not be included in this option.)

Proponents of these programs argue that energy markets are still far from perfect and that, consequently, federal intervention is still justified. The utilities area, for example, remains bounded by a wide array of federal and state regulations; those controls might distort the incentives facing private firms that want to undertake the necessary R&D for a new technology. Supporters also note that progress is certainly being made, although it has taken more time than planners originally estimated to develop new energy sources. The development of fusion science during the past year, for instance, has made great strides, although as a power source fusion is still only a distant hope. Advocates also note that some energy conservation and solar and renewable technologies developed at DOE laboratories have moved into the commercial market. In other cases, commercialization is being facilitated by further federal subsidies, such as high prices paid by federal power marketing authorities for the purchase of electricity generated by solar power. Researchers contend as well that government-supported R&D allows national goals to be met, an outcome that the private sector would not necessarily pursue.

Given the reduction in DOE's programs for developing nuclear weapons, cuts in energy R&D may be difficult to make. Many lawmakers and DOE officials have been counting on such civilian spending to help in converting DOE's R&D personnel and facilities from military to commercial uses. Cutting these energy R&D programs would leave fewer conversion alternatives for DOE's R&D infrastructure. In response, however, one could argue that going from one unneeded federal program to another would not be a helpful economic conversion.

DOM-04 ELIMINATE FURTHER FUNDING FOR THE CLEAN COAL TECHNOLOGY PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	0	0	288	288	288	864
Outlays	0	0	0	3	32	35
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	0	0	298	308	319	925
Outlays	0	0	0	3	33	36

The Clean Coal Technology Program (CCTP) was created in 1984 to assist private industry in developing commercial technologies that would use coal in environmentally sound ways. After five rounds of bid solicitations, the Department of Energy (DOE) will spend over $2.7 billion to fund and administer selected CCTP projects. The government's spending on those demonstration projects is limited to 50 percent of total costs. This option would complete projects already selected in rounds one through five of CCTP bid solicitations but eliminate any future funding for new projects. Savings would total less than $40 million in projected outlays over the 1996-2000 period measured from both the 1995 funding level and the 1995 level adjusted for inflation.

An initial goal of the CCTP was to reduce acid rain by supporting technologies that could lower the emissions of sulfur dioxide (SO_2) and nitrogen oxides (NO_x) that result from coal combustion. President Reagan declared that his Administration would honor an agreement with Canada to spend $2.5 billion on clean coal technologies aimed at helping curb acid rain in Canada. Other important goals of the program have been to promote the use of coal to replace imports of crude oil and to bolster the economies of coal-producing regions. Concerns about global warming and emissions of carbon dioxide have recently whetted policymakers' interest in increasing the efficiency of coal use.

Current practices that reduce SO_2 and NO_x emissions include cleaning the coal before burning it, scrubbing combustion gases to remove sulfur, switching to types of coal with a lower sulfur content, and switching to other fuels altogether. The new technologies that the CCTP supports fall into three general categories:

- Retrofit technologies that lower harmful emissions from existing coal-fired plants by cleaning the coal before combustion, reducing the level of gases emitted during combustion, or removing (or scrubbing) the gases emitted during combustion;
- Repowering technologies that replace all or part of existing boilers with advanced combustion systems that both reduce emissions and increase power output; and
- Conversion technologies that change coal into a liquid or gas.

Most of the projects funded by the CCTP will demonstrate technologies to retrofit or repower coal-burning electricity generating plants.

Federal support for new clean coal technologies may no longer be necessary. In the past, supporters of the CCTP viewed it as an alternative to legislation

controlling acid rain: the enactment of ill-timed controls could force industry to invest in current, high-cost abatement technologies when new, low-cost ones might be just around the corner. Since the passage of the Clean Air Act Amendments of 1990, however, the private sector has faced a clear legislative mandate for lowering coal emissions. Electric utilities and large industrial users of coal now have a clear economic motive for selecting from among current practices and new technologies the lowest-cost options for reducing emissions. DOE efforts may also be redundant in the light of independent research efforts by utilities themselves and by states that produce high-sulfur coal and want to maintain the product's sales. Moreover, the energy security benefit of increased coal use would be negligible, because coal today substitutes for oil in very few applications.

Alternatively, continued CCTP funding could hasten deployment of control and abatement technologies that would provide social benefits beyond what electric utilities would be willing to pay for under the Clean Air Act Amendments. Those benefits could come in the form of cleaner air and economic support for electricity consumers in general and for coal-producing regions in particular.

DOM-05 ELIMINATE THE DEPARTMENT OF ENERGY'S PRECOLLEGE EDUCATION PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	35	35	35	35	35	175
Outlays	23	33	35	35	35	161
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	36	37	38	39	41	191
Outlays	23	35	38	39	40	175

As part of its effort to increase the achievement of U.S. students in mathematics and science, the Department of Energy (DOE) spends $35 million on precollege mathematics and science education activities. Those activities have been criticized as ill-focused and unsupervised. They may also duplicate efforts in the same area by the Department of Education and the National Science Foundation (NSF). Eliminating the DOE program would save $23 million in 1996 and $161 million over the 1996-2000 time frame relative to the 1995 funding level. Relative to the 1995 funding level adjusted for inflation, the option would save $23 million in 1996 and $175 million over the 1996-2000 period.

In recent years, concern about the mathematics and science skills of U.S. precollege students has resulted in additional funds being devoted to those areas. The Department of Education and the NSF have received the bulk of both the resources and the responsibility for improving mathematics and science achievement. However, DOE's activities in precollege education have also grown during recent years, increasing from $2 million in 1990 to $35 million in 1995. DOE's program also includes some support to universities for research into science education.

The DOE program, undertaken under the Department of Energy Science Education Enhancement Act of 1990, focuses on three general areas: teacher enhancement, student support, and systemic reform. Activities related to teacher enhancement account for more than two-thirds of the program's budget; by contrast, systemic reform accounts for roughly one-tenth. Teacher enhancement projects are generally one-time events, typically without a follow-up program. (For instance, teachers might be brought in to conduct research at DOE for four to eight weeks during the summer.)

The evidence is weak that one-time experiences of that kind advance student achievement to a significant degree. The projects are subject to self-selection bias and attract the most scientifically adept teachers. Such teachers are already likely to know more than enough science to teach at the precollege level, so additional knowledge on their part may not contribute proportionately to students' achievement. Factors other than pure scientific knowledge--for example, enthusiasm, confidence, and classroom organizational skills--may be more important to success in teaching.

The issue of evaluation has also been raised in criticisms of the DOE program. The General Accounting Office (GAO) found that budget decisions in the precollege education program were not linked to project evaluations. Whether successful or not, projects received increased amounts of funding--in some cases, dramatically higher levels. In addition, GAO reports that the evaluations that were conducted contained technical flaws in their statistical method

ology. In response to GAO's evaluation, DOE has announced plans to improve the program's management and evaluation functions.

Similar programs sponsored by the NSF have been growing substantially and receive better evaluations than the DOE programs. A recent Stanford Research Institute assessment of the NSF programs indicates that, unlike the DOE efforts, they are integrated into larger state-level activities to improve student achievement in mathematics and science. Thus, rather than limited one-time summer efforts, the NSF is concentrating on creating assets--such as model schools and new curricula--that are not isolated from educational institutions and infrastructure at the state level.

Advocates of continuing the DOE precollege education program argue that the ability of the United States to remain an economic world leader depends crucially on whether the next generation of U.S. citizens can excel in technology development. In the past, students have excelled in part because the mission to the moon and other large federal science programs showed a previous generation of students how exciting scientific progress could be. DOE's research facilities give teachers a unique opportunity to encounter leading-edge science as it is actually practiced and to bring that experience back to their students. Furthermore, supporters argue that current methods of assessing students inadequately measure the higher-order, problem-solving skills that could be affected by teacher training and knowledge. If that argument is valid, the weak empirical links between teacher enhancement and student performance may say more about the strength of measurement tools than about the weakness of the program.

DOM-06 ELIMINATE ENERGY CONSERVATION GRANT PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	262	265	270	272	272	1,341
Outlays	68	213	256	272	272	1,081
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	271	285	300	312	323	1,491
Outlays	70	224	276	302	313	1,185

This proposal would halt new appropriations for three block grant programs that support energy conservation activities by the states. In 1995, the biggest of those appropriations is for weatherization assistance ($227 million), followed by institutional conservation ($29 million) and state energy conservation ($23 million). This option would halt new appropriations for those grant programs, saving $68 million in 1996 outlays and $1.1 billion in outlays from 1996 through 2000 measured against the 1995 funding level. The option would save $70 million in 1996 outlays and $1.2 billion in outlays from 1996 through 2000 measured against the 1995 level adjusted for inflation.

The Weatherization Assistance Program helps low-income households reduce their energy bills by funding such activities as installing weather stripping, storm windows, and insulation. The states have reported to the Department of Energy (DOE) that about 4 million homes have been weatherized since 1977, when the program began. The Institutional Grant Program helps reduce the use of energy in educational and health care facilities by adding federal funds to private and local public spending to encourage local investment in building improvements. And the State Energy Conservation Program funds projects that, for example, establish energy-efficiency standards for buildings and promote public transportation and carpooling. These three DOE programs are independent of a similar block grant activity, the Low Income Home Energy Assistance Program, administered by the Department of Housing and Urban Development.

Federal grants to promote less consumption of energy are in many respects an artifact of the mid-1970s and the widespread concerns about energy security--for all sources, including oil, natural gas, and coal--prevalent at that time. Today, those concerns are more correctly focused on imported oil supplies. Little benefit to the cause of oil-supply security can come from state grant programs that help reduce residential and institutional demand for natural gas and coal-generated electricity. And although the government has attached some urgency to the need to reduce energy use for environmental reasons, federal support for reducing the use of gas and coal through conservation grants for security or environmental needs is clearly at odds with other federal policies that simultaneously promote the production and use of those fuels.

In any case, the large savings of energy that states claim for these conservation programs may be overstated. Those claims have never been subjected to critical analysis by DOE or by any of the Congressional support agencies. According to DOE, total annual savings are on the order of 4.7 quadrillion Btus (British thermal units), a questionable result given that the figure represents over 15 percent of current energy use in the residential and commercial sectors. In contrast, the 4 million homes that DOE reports have benefited from energy conservation

grants constitute less than 5 percent of the total households in the United States.

Discontinuing the grant programs could impose hardships on states that wish to continue their energy conservation efforts but are experiencing financial distress. Many states still rely heavily on such grants to assist low-income households and public institutions. According to DOE, over 20 percent of all eligible buildings have had some energy improvements as a result of the Institutional Grant Program. The Weatherization Assistance Program currently helps weatherize about 100,000 homes per year, and more than 27 million homes remain eligible for assistance. Such figures may compel continued federal support in the energy conservation area. In 1994, however, the Congress allowed the legislative authorization for all three programs to lapse.

This proposal would not affect spending for the three DOE grant programs that are funded by offsetting collections (money that the Department of Energy receives in court settlements resulting from current prosecutions of violations of federal laws regulating petroleum prices in the 1970s). Those collections totaled $21 million in 1995, with additional amounts estimated to total between $40 million and $50 million over the 1996-2000 period.

DOM-07 SELL THE STRATEGIC PETROLEUM RESERVE

	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
From the 1995 Funding Level						
Budget Authority	194	244	244	244	244	1,170
Outlays	109	204	241	246	246	1,046
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	202	260	270	279	289	1,300
Outlays	113	216	262	276	286	1,153

The Strategic Petroleum Reserve (SPR) was first authorized by the Energy Policy and Conservation Act of 1975 (EPCA) to help safeguard the nation against the threat of severe disruptions of oil supplies. The SPR is a government-owned stock of crude oil, available for release at the discretion of the President in the event of a severe disruption of oil supplies or under the obligations of international agreements. The Department of Energy (DOE) has released oil from the SPR in emergency circumstances only once, during the Persian Gulf crisis. It has, in addition, released oil in test sales on two occasions.

The reserve currently holds 592 million barrels of crude oil stored in five underground sites. As amended in 1990, EPCA authorizes DOE to store up to 1 billion barrels of crude oil for emergency use. To date, DOE has constructed storage capacity for up to 750 million barrels. The department has plans to develop a capability for releasing, or "drawing down," oil from the reserve at a rate of 4.5 million barrels per day (bbl/day). Problems at several of the storage sites have brought the current drawdown capability to about 3 million bbl/day--nearly 50 percent of the nation's daily level of crude oil imports in 1994.

This option would terminate the SPR program and sell off all of the crude oil currently in the reserve along with all related storage and transportation facilities. Such a sale could generate budgetary savings from avoided appropriations for operations and maintenance. Outlay savings would total $1.0 billion over the 1996-2000 period measured against the 1995 funding level and $1.2 billion over that period measured from the 1995 level adjusted for inflation. Additional proceeds from the sale of crude oil and facilities could bring the total savings to more than $13 billion if the oil sales took place over a five-year period. Under current law, however, the proceeds from those assets would not count as budgetary savings.

As an alternative to terminating the entire SPR program, the government could save money by freezing the reserve at its current level. That option would result in minimal budgetary savings, however, because recent budget actions have essentially established a freeze at the current level. DOE still has more than $200 million of oil acquisition funds that would permit it to purchase another 15 million barrels of crude oil, which would bring the reserve up to 607 million barrels. In estimating savings, however, CBO assumed that much of those funds would not be spent for new oil.

The fundamental rationale for developing the Strategic Petroleum Reserve was an economic one. Specifically, an emergency release of strategic stocks of oil can help the nation sustain its economic output and consumption by lowering oil prices and enabling the economy to reduce its total oil imports. Depending on the circumstances of the crisis, a release may

also be of economic value because it can help the economy avoid the costs of adjusting to temporarily higher prices for oil.

Two general areas of concern underlie a proposal to terminate or scale back the SPR program. First, institutional changes in the oil market and the economy have reduced the potential costs of disruptions of oil supplies in ways that have lessened the potential benefits of releasing SPR oil in a crisis. Second, recent problems affecting the readiness of the SPR indicate that the future costs of maintaining the reserve will be greater than previously assumed.

The potential benefits from releasing SPR oil are smaller today than they were in the past because the economy is better able to accommodate a disruption of oil supplies without major adverse effects. In particular, a number of institutional changes in oil markets and the economy now allow the United States to significantly lower its requirements for imported oil on short notice. As a result, the nation's payments for imports do not rise commensurately with oil prices. For example, because petroleum prices today are not regulated, the domestic oil market receives the proper price signals to reduce the use of oil and increase domestic production in response to an oil price shock. And institutions such as futures markets have reduced the pressure on businesses to accumulate private stocks of oil during a crisis, which further curtails oil imports. Moreover, the role of oil in the nation's economic activities is smaller today than it was in the past: businesses and individuals make greater use of other fuels and use all fuels more efficiently than in the 1970s, when the SPR was conceived. As a result, any rise in oil prices today has a smaller effect on inflation and, in turn, less impact on real income and consumer expenditures.

Aside from declining benefits, the growing costs of maintaining the SPR also strengthen the case for eliminating it. After nearly 20 years, many of the SPR's facilities are showing signs of age in ways that both reduce the SPR's drawdown capabilities and point to the need for mounting expenditures on maintenance in the future. Today, the SPR can effectively distribute about 3 million bbl/day for 90 days--far below the design capacity of the reserve. The smaller drawdown capability stems from problems with natural gas seepage into some of the storage caverns and excessive heat. The seepage produces an excessive gas content in the oil and makes it too volatile for transportation. Excessive heat in the storage caverns creates higher vapor pressure for the crude oil and increased air emissions during drawdown. Those problems mean that about 200 million barrels of SPR oil cannot be safely removed. A third problem that is reducing the availability of SPR oil even further is water leakage in caverns that hold a total of 73 million barrels of oil.

Arguments against eliminating the reserve are rooted in an alternative view of its benefits and costs. Proponents of keeping the SPR contend that the economic costs of maintaining the reserve may still be significantly less than the potential benefits to be gained from releasing that oil during a future disruption of oil supplies. A further argument calls for retaining the SPR as a national security asset. For example, the federal government is a major consumer of oil, and the SPR could be a supply for its use. Moreover, to the extent that the United States is in a position to affect the world supply of and demand for oil through its military and geopolitical activities, it will have greater freedom to pursue those activities if it can use the SPR to ameliorate their effects on world oil prices.

DOM-08 ALLOW PRIVATE PRODUCERS TO BUILD AND OPERATE COGENERATION FACILITIES AT FEDERAL CIVILIAN INSTALLATIONS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	0	0	30	30	30	90
Outlays	0	0	10	25	30	65
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	0	0	30	30	30	90
Outlays	0	0	10	25	30	65

Over the years, the Department of Defense has entered into agreements with private power producers to build and operate cogeneration facilities at some of its installations. Those facilities provide electricity and heat to the installations and then sell off any excess electricity they produce to private users. Cogeneration conserves energy because power plants produce heat and electricity at the same time and from the same energy source. But title VIII of the Shared Energy Savings Amendment of the National Energy Conservation Policy Act of 1978 restricts power plants at nondefense federal installations from making similar arrangements.

Allowing private utilities to cogenerate electricity and heat at the government's civilian facilities could save about $65 million in outlays over the next five years by reducing appropriations of budget authority by roughly $90 million in the same period. Such potential reductions in budget authority from the 1995 funding level are preliminary estimates that make no significant distinction between inflated and uninflated savings. (Thus, the table shows identical preliminary estimates of savings from both the 1995 funding level and the 1995 level adjusted for inflation.) Civilian federal agencies--primarily the Department of Energy but also the National Aeronautics and Space Administration, the General Services Administration, and the Department of Veterans Affairs--could avoid the cost of rebuilding aging plants that provide steam to heat buildings and power industrial processes. This option assumes that private investors would pay all construction costs for replacing obsolete federal power plants and assume all of the financial risk related to the investment. Actual savings would depend on which projects were selected for replacement and when. Additional savings--not included in the table--could result from lower utility costs for government agencies if the private providers operating the cogeneration facilities sold steam and electricity at lower rates than the agencies now pay. The Administration included this proposal in its National Performance Review.

Proponents of the proposal note that it would reduce federal outlays while increasing electricity generating capacity and conserving energy. The new cogeneration facilities would be more efficient than current facilities, requiring less energy to produce electricity. But achieving that efficiency requires that private producers be allowed--as they would be under this option--to sell off-site any excess electricity they generated. Even federal facilities with steam plants that do not need rebuilding could lower their heating and electricity costs by allowing private developers to build and operate cogeneration facilities.

A disadvantage of this proposal is that some utilities that now provide electricity to federal civilian agencies might well object to losing a portion of their business; in addition, under the Public Utility Regulatory Policies Act, they would be required to buy

excess power from the new cogeneration facilities. The total amount of power involved, however, is not large, and the effect of this option on utilities would vary greatly--depending on cost factors and the price-setting rules used by public utility commissions. Some utilities might welcome the new source of power, but others with sufficient generating capacity for their needs might resent having to make required purchases of electricity from the cogeneration facility.

DOM-09 ELIMINATE ELECTRIFICATION AND TELEPHONE CREDIT SUBSIDIES PROVIDED BY THE RURAL UTILITIES SERVICE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	62	62	62	62	62	310
Outlays	6	15	35	49	59	164
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	64	66	68	71	73	342
Outlays	6	15	36	53	64	174

The Rural Utilities Service (RUS) is an agency within the Department of Agriculture that, among other activities, provides financial assistance in the form of subsidized loans and grants to electric and telephone companies serving primarily rural areas. This option addresses only the credit subsidies provided through loans for electrification and telephone service that were previously administered by the Rural Electrification Administration (REA). The former REA programs were combined with other loan and grant programs in 1994 to form the RUS. (Additional potential savings from cutting other RUS programs are described in DOM-31.)

For 1995, RUS subsidies to electric and telephone companies total about $60 million. In addition, the agency spends nearly $40 million per year administering those programs. Eliminating the credit subsidies for loans made or guaranteed by the RUS would reduce outlays by an estimated $6 million in 1996 and $164 million between 1996 and 2000 measured from the 1995 funding level. Total savings over that period from the 1995 funding level adjusted for inflation would be $174 million.

Most of the borrowing that the REA subsidized was established in the 1930s, 1940s, or 1950s. Many communities served by those borrowers are now much larger than the original service-area requirement of no more than 1,500 inhabitants. In total, the agency's borrowers serve about 10 percent of the nation's electricity consumers and about 4 percent of its telephone customers.

Credit subsidies for loans to rural electric and telephone companies were reduced by more than one-half from 1993 to 1994, reflecting the significant changes in the program enacted in the Rural Electrification Loan Restructuring Act of 1993. Moreover, because the cost of federal borrowing declined significantly in 1992 and 1993, the average subsidy provided for the RUS's low-interest (5 percent) loans also decreased. Before passage of the 1993 act, most RUS borrowers were eligible for 5 percent loans. Under the restructured program, some borrowers are still eligible for the 5 percent loans; others may borrow from the agency at slightly higher (although still subsidized) rates; and still others may borrow either at the rate that the Treasury pays to borrow or 7 percent, whichever is less. Although the appropriation for the cost of subsidies for all lending related to rural electrification and telephone service declined from about $200 million in 1993 to about $60 million in 1995, the agency may still make new loans totaling close to $1 billion this year--slightly less than the level in 1994.

The savings shown in the table could result from either of two scenarios: discontinue lending and require RUS borrowers to use private sources of capital for all of their loan needs, or continue a federal loan program but eliminate subsidies. A loan program

with no subsidy costs would require raising the interest rates on loans to rural electric and telephone companies to the level of the Treasury's cost of borrowing; it would also mean charging small loan origination fees to cover the cost of defaults for certain classes of loans. In addition to savings in subsidy costs, some savings in administrative costs could be achieved if all such lending was discontinued. Some of the nearly $40 million per year in current salaries and expenses would be required to administer existing loans, but those costs could be gradually reduced under the no-new-lending option. Potential administrative savings of more than $30 million over the 1996-2000 period could be achieved by eliminating the program, but those additional savings are not counted in this option.

The loan program for rural electrification and telephone service has largely fulfilled its original goal of making those services available in rural communities. Yet many borrowers still depend on federal loans to maintain and expand those utilities. Increasing the interest rates or charging origination fees on some loans would raise the rates such borrowers charge their customers, especially in the rural regions that are most affected. Borrowers argue that they need some level of subsidization to keep their service and utility rates comparable with those in urban areas. Most RUS borrowers already use some private financing, however. Because the cost of interest accounts for only a small percentage of the typical customer's bill, eliminating the remaining federal subsidy would have little effect on the utility rates that most borrowers charge their customers.

DOM-10 ELIMINATE BELOW-COST TIMBER SALES FROM NATIONAL FORESTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	20	35	50	65	80	250
Outlays	15	30	45	60	75	225
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	20	35	50	65	80	250
Outlays	15	30	45	60	75	225

The Forest Service (FS) manages federal timber sales from 119 national forests in the national system. In 1994, the FS sold roughly 3.0 billion board feet of public timber under contract to private lumber companies. The total 1994 harvest, approximately 4.8 billion board feet providing about $800 million in federal timber receipts, represented a continued decline in volume from previous years. In 1994, the FS spent over $900 million on timber management, reforestation, construction of logging roads, payments to states, and other timber program costs. The net result for the program as a whole was a situation in which costs exceeded receipts.

In seven of the nine National Forest System regions, annual cash receipts from federal timber sales have consistently failed to cover the FS's annual cash expenditures. For example, in three of these so-called below-cost timber sale regions--the Rocky Mountain, Northern, and Intermountain--cash expenditures have exceeded cash receipts by a ratio of about 3 to 1, on average, over the past decade. (Annual timber program costs in the three regions still exceed annual timber receipts if FS expenditures for road construction are excluded.) The FS does not maintain the data needed to estimate annual timber receipts and expenditures associated with each separate timber sale; it is therefore hard to determine precisely the budgetary savings that could be achieved by phasing out all below-cost timber sales in the National Forest System. As an illustration of the potential savings, however, eliminating all future timber sales from the three regions mentioned above would reduce FS outlays over the 1996-2000 period by $290 million, including savings in the timber road budget. Timber receipts would be reduced by about $65 million. Net savings in federal budget outlays over the 1996-2000 period would be about $225 million. Because the estimated savings are based on an actual program estimate of the cost of building roads in the three regions, the savings would be the same whether measured against the 1995 funding level or that level adjusted for inflation.

Below-cost timber sales have several potential disadvantages. They may lead to an increase in the federal deficit, wasteful depletion of federal timber resources through uneconomic harvests, unwarranted destruction of roadless forests valued by many recreational visitors, and government interference with private timber markets.

One advantage of the sales, however, is that the FS timber program generates benefits to the government other than financial ones. Among these are community stability in areas dependent on the federal timber industry for logging and other related jobs and increased access from road construction for fire protection and recreation. Community stability could be particularly important in light of current court injunctions--to protect the spotted owl--that have reduced harvesting activities in some areas. The risk of economic hardship from eliminating the federal timber program in those areas could be reduced by gradually

lowering the level of below-cost timber sales, by providing federal job-replacement-skills programs, and by encouraging greater development of other activities--such as tourism and recreation--in the national forests.

DOM-11 REDUCE BUREAU OF MINES FUNDING FOR MINING AND RELATED TECHNOLOGY DEVELOPMENT EFFORTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	18	36	54	73	91	272
Outlays	12	29	47	65	84	237
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	22	45	67	90	113	337
Outlays	14	36	58	81	104	293

The U.S. Bureau of Mines (USBM) disseminates information and conducts research and development related to mining activity and the use of minerals. This option would reduce USBM funding for near-term development of specific products and technologies while preserving the agency's programs for information dissemination and basic research. To accomplish those goals, funding for areas of the agency's program other than information would be reduced to 25 percent of its 1995 level, with those reductions phased in over the 1996-2000 period. In total, over the five-year period, that change would save $237 million in outlays measured from the 1995 funding level and $293 million measured from the 1995 level adjusted for inflation.

USBM currently groups its research and development work in several categories: environmental remediation, pollution prevention and control, health and safety, and materials research partnerships. Included in those groupings, however, are efforts that the agency previously identified as mining technology and minerals and materials science. Much of that funding, regardless of classification, is for research and development specific to identifiable mineral commodities, new materials, and mining technologies. The products of those efforts are frequently of direct interest and value to the mining industry (including mine workers) and to government agencies such as the Department of Energy, the Department of Defense, the Environmental Protection Agency, and the Department of Labor. In fact, a part of USBM's work receives financial support from all of those groups.

Proponents of the option to reduce USBM funding do not question the merits of such development work--especially in instances in which its benefits are evidenced by the availability of outside support. Two general concerns exist. First, proponents doubt the necessity for a government role, especially a role that so strongly supports one particular industry. (See DOM-03 for a related discussion of the merits of government development of energy technologies.) A general case may be made for the government's involvement in markets whenever structural factors impede the efficient production and pricing of an activity. The high cost of information may be one such impediment and could serve as a rationale for government efforts to collect and disseminate data on mineral availability and market activity. Similarly, the high costs and uncertain paybacks associated with basic scientific research could be used to justify government support of such research.

However, for products or technologies with identifiable commercial value, the case for government support is less compelling. Industry's willingness to fund specific research and development activities, for example, suggests that in those areas, the USBM is subsidizing something that the private sector would do on its own.

The second concern relates to the efficiency of the government's efforts. Government agencies have historically demonstrated only limited success in identifying commercially viable innovations and bringing them to market. Although the USBM can point to a long list of patents that it has received and licenses for commercial production that it has issued, such successes are rarely the whole picture. Some of the development work has been in areas with no commercial interest; in other areas, existing products or technologies compete with the government's output, indicating that the incremental contribution of the government's work is small and that the government may be crowding out private research. In general, evaluating claims of the government's success in its research endeavors is difficult without comparing the total government funds expended with measures of commercial success (such as licensing revenues)--calculations that scientific agencies rarely make.

Supporters of the USBM argue that much of the agency's research and development directly supports national policies related to protecting the environment, promoting health and safety, and bolstering a vital industry. For example, as a consequence of their research work, USBM staff are uniquely qualified to contribute to the development of technologies to locate and clean up abandoned mining sites. In addition, supporters argue that some of the work that the USBM does would not otherwise be done and that in cases in which USBM activities overlap those of other government agencies, the USBM has a better record of productivity and cost efficiency.

This option includes discontinuing federal production of helium, which is an activity of the USBM. That program was intended to help ensure adequate supplies for federal scientific and defense activities. Federal production, however, now accounts for only 10 percent of total U.S. production. Ending it would result in a small increase in net receipts that would appear as an annual decrease of $8 million in on-budget outlays, after the incurring of some initial costs. Federal production facilities--worth about $10 million--could be sold, but those receipts are not included in the savings estimated for this option. The option assumes that the Department of the Interior would maintain the federal helium reserve.

DOM-12 ELIMINATE FEDERAL GRANTS FOR WATER INFRASTRUCTURE PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	2,962	2,962	2,962	2,962	2,962	14,810
Outlays	181	850	1,768	2,458	2,808	8,065
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	3,060	3,163	3,276	3,389	3,507	16,395
Outlays	187	885	1,863	2,641	3,093	8,669

The Clean Water Act (CWA) and the Safe Drinking Water Act prescribe performance requirements for municipal wastewater and drinking water systems to protect the quality of the nation's water and the safety of its supplies of drinking water. The Clean Water Act also provides financial assistance so that communities can construct wastewater treatment plants that comply with the provisions in the act. (The CWA requires secondary treatment of wastewater to remove at least 85 percent of raw pollutants.) The Congress has appropriated about $3 billion for water infrastructure programs for 1995 including funds for wastewater programs and a new program for drinking water facilities.

Construction grants for wastewater treatment plants were first authorized in 1972 under the Title II categorical grant program of the CWA. The Environmental Protection Agency (EPA) administered the construction grant program by providing assistance directly to municipalities for wastewater treatment projects. (Federal funds for the program were and still are channeled through EPA's annual appropriations.) Since 1972, the Congress has appropriated about $65 billion to assist localities in complying with the CWA.

The Clean Water Act, as amended in 1987, phased out Title II grants and authorized a new grant program under Title VI to support state revolving funds (SRFs) for water pollution control. In the new regime, states continue to receive federal grants but are now responsible for developing and operating their own programs. For each dollar of Title VI grant money that a state receives, it must contribute 20 cents to its SRF. States then use the combined funds to make low-interest loans to communities to construct or upgrade municipal wastewater treatment facilities. Local agencies that borrow funds from the SRF for construction must repay them, thus creating a revolving source of capital for other local communities.

The Congressional Budget Offic has projected that support for federal grants for water infrastructure will continue at the 1995 level of $3 billion, adjusted for inflation. Ending all funding of new water infrastructure projects after 1995 would save $181 million in 1996 and $8.1 billion through 2000 measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $187 million in 1996 and $8.7 billion over the five-year period.

Federal contributions to the SRFs were intended to help in the transition to full state and local financing of the funds by 1995. Proponents of eliminating federal grants to SRFs argue that the program was meant to be temporary and may have replaced, rather than supplemented, state and local spending. They also point out that in some cases, the grants may have encouraged inefficient treatment decisions by making it possible for SRFs to loan money at below-market rates of interest. Below-market rates could reduce

the incentives for local governments to find less capital-intensive and less costly alternatives for controlling water pollution.

Opponents of such cuts argue that states and localities would find it more difficult to meet the federal treatment deadlines without continued federal contributions because repayments to the SRFs would be insufficient to fund new projects and states would be unable to shoulder the additional cost of decreased contributions to the SRFs. For example, EPA estimates that additional treatment facilities and upgrades--at a cost of $127 billion--would have to be built over the next two decades for states to meet the current goals set by the CWA. Some people who oppose eliminating federal grants maintain that cutting federal funds would increase the burden of unfunded mandates on state and local governments.

DOM-13 DE-EMPHASIZE PERMANENCE IN SUPERFUND CLEANUPS; EMPHASIZE LAND USE IN CHOOSING CLEANUP LEVELS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	150	150	150	150	150	750
Outlays	38	90	120	135	143	526
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	155	167	173	179	186	860
Outlays	39	96	133	154	168	590

Estimates of the size of the nation's hazardous waste problem and of the resources required to resolve it have grown substantially since the Superfund program was established in 1980. The Environmental Protection Agency (EPA) expects to spend a total of $27.3 billion on cleaning up the first 1,248 sites on the National Priorities List (NPL), including $13.3 billion in 1995 and beyond. Substantial related expenditures will be required by the Energy and Defense Departments and by other agencies responsible for federally owned hazardous waste sites. Moreover, new sites continue to be added to the NPL. A Congressional Budget Office (CBO) study, *The Total Costs of Cleaning Up Nonfederal Superfund Sites* (January 1994), estimated that EPA's future Superfund costs may be between $35 billion and $130 billion, depending on the ultimate number of nonfederal NPL sites.

One way to reduce these large costs is to change the standards and methods used to protect health and the environment at Superfund sites. Less stringent cleanup standards could be chosen when they were consistent with the expected use of the land in the future, and the statutory preference for permanent treatment technologies could be relaxed to allow more use of containment methods, such as caps, slurry walls, and surface water diversion. An unpublished EPA analysis estimated that a set of such changes proposed by the Administration in 1994 would reduce annual cleanup costs in the Superfund budget by $156 million, or 19 percent. That figure is consistent with a range of savings of $101 million to $162 million calculated independently by the Office of Management and Budget. An earlier study conducted at the University of Tennessee argued that a judicious shift toward containment methods and institutional controls, such as deed and access restrictions, could reduce remediation costs by 40 percent without sacrificing environmental protection.

Based on the EPA analysis, CBO estimates that changes in cleanup standards like those proposed last year could reduce outlays for Superfund cleanups by $526 million over the 1996-2000 period measured from the 1995 funding level, or $590 million measured from the 1995 level adjusted for inflation. To realize those savings, budget authority for the Superfund program would have to be cut in the annual appropriation process. (Total savings could be somewhat greater if the Congress also cut budget authority for Superfund's enforcement activities, on the grounds that the private parties legally responsible for cleanup would have less incentive to contest their liabilities. Potentially large additional savings could result from cutting appropriations for related cleanup programs of the Departments of Energy and Defense.) Alternatively, the Congress could choose to maintain appropriations at 1995 or 1995-plus-inflation levels to increase the number of sites undergoing cleanup at one time (which would push the deficit savings off into the future). Another approach would

be to reduce the dedicated Superfund taxes, thereby sharing some or all of the potential deficit savings with private-sector taxpayers.

Proponents of this option argue that it is wasteful to spend more on Superfund cleanups than is necessary to protect health and the environment and that the use of more permanent remedies (such as incineration, bioremediation, and vitrification) can be deferred until land-use needs are clearer and treatment technologies are better developed. Opponents argue that the option may not provide as much protection as supporters claim and that invoking it would be unfair to local communities (which would bear the disruptive effects of the land-use restrictions) and to future generations (which would bear any costs of replacing interim cleanups with more permanent measures). Some opponents also assert that the lion's share of cost savings from any significant reduction in remediation requirements should take the form of cuts in the taxes that provide the primary financing for the Superfund trust account. Modifying the proposal in that way would substantially reduce the net benefit to the federal budget.

DOM-14 IMPOSE A FIVE-YEAR MORATORIUM ON LAND PURCHASES BY THE DEPARTMENTS OF AGRICULTURE AND THE INTERIOR

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	235	235	235	235	235	1,175
Outlays	78	163	219	235	235	930
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	243	252	261	270	280	1,306
Outlays	81	171	235	260	270	1,017

The Departments of Agriculture and the Interior currently spend about $200 million per year for land that generally is used to create or expand designated recreation and conservation areas. (Such areas include national parks, national forests, wilderness areas, and national wildlife refuges.) Purchases are made directly by the federal government or through grants to states and localities; participating state or local governments match the grants dollar for dollar. Placing a five-year moratorium on future appropriations for land purchases and state grants by these departments would save $78 million in 1996 and $930 million between 1996 and 2000 measured against the 1995 funding level, and $81 million in 1996 and $1.02 billion between 1996 and 2000 measured against the 1995 level adjusted for inflation. The option would allow agencies to use unobligated funds for emergency acquisition of important tracts that became available on short notice, for compensation to "inholders"--landholders whose property lies wholly within the boundaries of an area set aside for public purposes (for example, a national park)--and for ongoing administrative expenses.

Most federal lands are managed by the National Park Service, the Forest Service, or the Bureau of Land Management. In many instances, those agencies find it difficult to maintain and finance operations on their existing landholdings. Proponents of this proposal argue that land management agencies should improve their stewardship of the lands they already own before being faced with additional management responsibilities. Some argue further that, given these agencies' limited operating funds, environmental objectives such as habitat protection and access to recreation would be best met by improving management in fewer areas rather than providing minimal management over a larger number.

Another argument made in favor of this proposal is that the federal government already owns enough land. Currently, 650 million acres (approximately 30 percent of the land nationwide) belong to the government. The sentiment that that amount is sufficient is particularly strong in the western United States, where nearly half of the land area of 11 states is under federal ownership.

Opponents argue that future land purchases are necessary to achieve ecosystem management objectives as well as to fulfill existing obligations for national parks. Much of the land targeted by the Congress for new and expanded federal reserves is privately held; its acquisition will require purchases. Furthermore, encroaching urban development and related activities that originate outside the boundaries of national parks and other federal landholdings may be damaging resources inside the parks. Land acquisition is an important tool for mitigating that problem. Acquisitions that consolidate landholdings may also help to improve the efficiency of public land management.

DOM-15 REDUCE FEDERAL SUPPORT FOR AGRICULTURAL RESEARCH AND EXTENSION ACTIVITIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	172	172	172	172	172	860
Outlays	107	153	168	170	172	770
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	178	184	191	198	206	957
Outlays	111	162	184	193	202	852

The Department of Agriculture conducts and supports agricultural research and education. In particular, the Agricultural Research Service (ARS), the department's internal research arm, operates at locations throughout the country; its research focuses on maintaining and increasing the productivity of the nation's land and water resources, improving the quality of agricultural products and finding new uses for them, and improving human health and nutrition. The newly created Cooperative State Research, Education, and Extension Service (CSREES) has been assigned responsibility for all cooperative state and other research programs previously performed by the Cooperative State Research Service and for all cooperative education and extension programs previously performed by the Extension Service. (Traditionally, the Cooperative State Research Service has supported agricultural research at land-grant universities and other state institutions. The Extension Service has introduced farmers to new technology and educated low-income families about good nutrition; it has also provided some services to urban residents.) The Economic Research Service (ERS) conducts and supports agricultural economic and other social science research, outlook forecasting, policy analysis, and the development of indicators related to U.S. and international agriculture, food, natural resources, and rural America.

The 1995 appropriations for these three agencies total $1.7 billion. Reducing funding levels by 10 percent would save $770 million in outlays over the 1996-2000 period measured from the 1995 funding level and $852 million measured from the 1995 level adjusted for inflation.

Research and grants provided by the ARS, CSREES, and ERS may, in some cases, be replacing funding from the private sector. If federal funding was eliminated in those cases, the private sector would be forced to finance more of its own research. Moreover, federal funding for some extension activities under the CSREES could be reduced without undercutting its basic services to farmers. For example, funding for a Nutrition Education Initiative, the Nutrition and Family Education program, and Youth at Risk programs amounted to $76 million under the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act for 1995.

Research and extension activities have long played important roles in developing an efficient farm sector--a reduction in federal funding could compromise the sector's development in the future and its competitiveness in world markets. If the burden of funding was transferred to the private sector, agricultural research, which helps provide U.S. consumers with an abundant, diverse, and relatively inexpensive food supply, could decline. Moreover, some federal grants are used to improve human, animal, and plant health by funding research that pro-

motes better nutrition or more environmentally sound farming practices. If federal funding was cut back, the direct budgetary savings would be substantial, but the public could bear some of the cost in higher prices, forgone innovations, or environmental degradation.

DOM-16 REDUCE DEPARTMENT OF AGRICULTURE SPENDING FOR EXPORT MARKETING AND INTERNATIONAL ACTIVITIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	22	22	22	22	22	110
Outlays	14	20	22	22	22	100
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	23	24	25	26	27	125
Outlays	14	22	24	25	26	111

The Department of Agriculture runs many programs to promote exports and international activities through the Foreign Agriculture Service (FAS). FAS develops foreign markets by jointly funding--with U.S. trade and commodity organizations called "co-operators"--overseas advertising campaigns, trade show exhibits, and promotional materials. FAS also collaborates on a variety of other ventures, one of which provides training to foreign nationals with the objective of improving commercial relationships that will benefit U.S. agriculture. Eliminating funding for these programs would reduce outlays by $100 million over the 1996-2000 period measured from the 1995 funding level and $111 million measured from the 1995 level adjusted for inflation.

Although the cooperator program has served a useful purpose, it may be ready to revert to private enterprise, with no financial assistance from FAS. The program has tended to promote basic commodities, such as grains, oilseeds, and cotton. It is uncertain how much return in terms of market development the cooperator program is generating. In addition, private, brand-name advertising is sponsored in this program, and many people object to spending taxpayer money on such activities.

The Cochran Fellowship Program affords a selected group of foreign midlevel managers a visit to the United States and training in agriculture and agribusiness. The direct benefits to U.S. agriculture are unknown, and although the program is popular among the recipients and their sponsors, it may be of marginal value to taxpayers.

However, some observers maintain that U.S. agriculture, processors, and traders would be hurt if federal funding for the cooperator and fellowship programs was eliminated. In particular, they might suffer from less business abroad, especially over the long run, if funding was cut.

DOM-17 REDUCE LOANS MADE BY THE FARMERS HOME ADMINISTRATION FOR FARM OWNERSHIP AND OPERATIONS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	57	57	57	57	57	285
Outlays	53	57	57	57	57	281
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	57	59	62	64	66	308
Outlays	53	59	61	63	66	302

The Farmers Home Administration (FmHA) lends money directly to new farmers, or farmers of limited means who cannot obtain loans elsewhere, for purchasing land or materials to operate a farm. FmHA makes some of those loans at interest rates that approximate the Treasury's cost of borrowing money. More than 80 percent of the money spent on direct loans, however, is for loans made to so-called limited-resource borrowers at interest rates below that of the Treasury. Eliminating those below-cost loans would save the federal government $281 million in outlays over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $302 million over the five-year period.

In recent years, the amount of direct loans made by FmHA has fallen while the volume of commercial loans guaranteed by FmHA and used for the same purposes has increased. FmHA's guaranteed loans typically cost the government less than direct loans; as a result, they allow more farmers to receive assistance from the same amount of funds. Eliminating the highly subsidized direct loans would accelerate the downward trend of funding yet still provide a core amount of low-interest direct loans (but at no less than the Treasury's low rates) for those farmers who were unable to secure guaranteed loans from commercial lenders.

Proponents of eliminating the loans to limited-resource borrowers argue that there are too many farmers already and that the government should not be encouraging new farmers at a time when excess farm production triggers spending for other agricultural benefits such as subsidies. Furthermore, the Congress and FmHA intended direct loans to be available to borrowers only temporarily--until those farmers could improve their operations and qualify for commercial credit. But evidence reported by the General Accounting Office suggests that the "graduation rate" of current borrowers from direct to guaranteed loans is low, in part because incentives are lacking to encourage borrowers of FmHA money to shift from below-cost loans to guaranteed loans. One way to promote that move is to lessen the availability of direct loans.

Opponents of this option are concerned about the need to provide credit to beginning farmers. Funds for buying a farm or for expenses to operate a farm are often unavailable from commercial sources--particularly for young farmers. The rising median age of farmers and the growing cost of acquiring a farm of an economical size give highest priority, in the view of some people, to assisting the next generation of farmers.

DOM-18 END SMALL BUSINESS ADMINISTRATION LOANS AND LOAN GUARANTEES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
End All Credit Programs						
From the 1995 Funding Level						
Budget Authority	693	693	693	693	693	3,465
Outlays	445	638	668	668	668	3,087
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	717	742	768	796	824	3,847
Outlays	476	700	757	784	812	3,529
Keep Minority and Disaster Programs						
From the 1995 Funding Level						
Budget Authority	431	431	431	431	431	2,155
Outlays	290	418	431	431	431	2,001
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	441	457	474	490	508	2,370
Outlays	296	438	468	484	502	2,188

The Small Business Administration (SBA) provides both direct loans and loan guarantees to qualified small businesses. The SBA's lending objectives are to promote business development generally, aid economically disadvantaged groups, and assist small businesses and homeowners in recovering from disasters. Eliminating all SBA loan and loan guarantee programs would reduce outlays by $3.1 billion over the 1996-2000 period measured against the 1995 funding level and by $3.5 billion relative to the 1995 level adjusted for inflation. An alternative to eliminating all loans would be to retain only those that provide assistance to minorities and disaster victims. Continuation of those programs could be justified as aid to the socially or economically disadvantaged because of factors beyond their control. Following that course could reduce SBA outlays by $2.0 billion over the 1996-2000 period measured against the 1995 funding level and by $2.2 billion relative to the 1995 level adjusted for inflation.

Under the loan guarantee program, the federal government guarantees 90 percent of the principal for business loans up to $155,000 and between 70 percent and 85 percent of the principal for larger ones. The interest rate on guaranteed loans is about 2.5 percentage points above the prime rate; in addition, the SBA guarantee has a charge equal to 2 percent of the amount guaranteed. In 1994, the SBA guaranteed 38,407 loans totaling more than $7 billion; the SBA's share of the guaranteed loans was roughly $6 billion. Holders of 2,821 guaranteed loans defaulted in 1994, and the loans were subsequently purchased by the SBA. The SBA's share of the outstanding balances of those loans exceeded $497 million.

Under the direct loan program, the SBA provides loans to businesses located in high-unemployment or low-income areas and to businesses owned by minorities, handicapped individuals, and Vietnam veterans or disabled veterans. It also offers direct

loans to homeowners recovering from natural disasters. Direct loans generally do not exceed $150,000, although some disaster loans run as high as $500,000. In 1994, the SBA approved 116,281 direct loans totaling $3.8 billion, bringing the total direct loan portfolio to more than $6.1 billion. In both the direct loan and loan guarantee programs, the SBA extends credit for up to 25 years--a significantly longer term than would otherwise be available to small businesses.

SBA assistance is favored by those who view it as a way of aiding small businesses, which, they argue, generally create more jobs, improve technology more rapidly, and satisfy some markets more efficiently than do large firms. When banks and other traditional sources of loans to small businesses tighten credit standards or become more conservative in their lending practices, SBA assistance can help to fill a financing gap.

But others claim that SBA assistance tends to flow to the firms least likely to create stable employment, improve technology, or enhance national productivity. SBA loans and loan guarantees go primarily to businesses that have been rejected by conventional providers of financing. Perhaps as a result, they have a high default rate. It can also be argued that financial markets are now more efficient and less susceptible to the types of market failure that justified the SBA program when it first began.

DOM-19 ELIMINATE THE SMALL BUSINESS ADMINISTRATION'S TREE PLANTING PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	15	15	15	15	15	75
Outlays	15	15	15	15	15	75
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	16	16	17	17	18	84
Outlays	16	16	17	17	18	84

The tree planting program within the Small Business Administration (SBA) provides federal funds for contracts between states and small businesses to plant trees on public lands controlled by state or local governments. The federal government will fund up to 75 percent of the cost of such contracts. Eliminating SBA's tree planting program would save $15 million in 1996 and $75 million from 1996 through 2000 measured against the 1995 funding level. Relative to the 1995 level adjusted for inflation, this option would save $16 million in 1996 and $84 million from 1996 through 2000.

The tree planting program within SBA was created by authorization language in the 1991 appropriation act for the Commerce Department. The program is intended to support small businesses. Most of the contracts awarded through this program are for planting trees along roadsides, in parks, and on the grounds of public facilities such as schools. Only a small part of the funding is used for reforestation.

Half of the federal funds for the program are allocated to states on a per capita basis. More populous states thus tend to receive more funds for tree planting than less populous ones. In allocating the remaining funds, the SBA gives priority to states that are willing to pay more than 25 percent of the cost of the contract. In 1993, all of the 50 states and the District of Columbia were awarded money through this program. In the majority of cases, the states then made subgrants to local governments.

Calls have come for the elimination of the program. For example, the President's 1993 and 1995 budgets contained such proposals. One argument that supporters of elimination make is that tree planting on land owned by state and local governments should be funded by those governments and not at the federal level.

Proponents of retaining the program point out that since SBA's national tree planting program is restricted to public land controlled by state and local governments, it does not duplicate similar programs of other federal agencies. (Tree planting funded by the Forest Service within the Department of Agriculture is generally for the reforestation or improvement of federal and private lands.) Supporters also contend that eliminating the SBA program would reduce the incentive for state and local governments to plant trees on the public lands under their control. In addition, it would cut a source of federal support for small businesses.

DOM-20 REDUCE THE BUDGET OF THE EXPORT ADMINISTRATION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	10	10	10	10	10	50
Outlays	8	9	10	10	10	47
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	10	11	11	11	12	55
Outlays	9	10	11	11	12	53

The Export Administration (EA) of the Department of Commerce enforces U.S. export laws to promote national security and foreign policy objectives. Its activities include ensuring availability of industrial resources for U.S. defense, licensing exports, and detecting and preventing foreign distribution of U.S. goods and technical data that are controlled for reasons of national security or foreign policy. Reducing the budget of the Export Administration by 25 percent would save $8 million in outlays in 1996 and $47 million over five years measured from the 1995 spending level. It would save $9 million in 1996 and $53 million over five years measured from the 1995 spending level adjusted for inflation.

The enforcement activities of the EA reduce U.S. exports and thereby create economic inefficiencies that reduce U.S. gross national product. To the extent that they keep defense-related goods and technology out of the hands of potential adversaries, however, they promote U.S. security and foreign policy. The EA's activities to ensure availability of industrial resources (such as restricting foreign ownership of U.S. firms that are deemed to be defense-related) also have their economic efficiency costs and corresponding national security and foreign policy benefits.

With the demise of the former Soviet Union, many people believe that restrictions on exports can safely be eased, but agreement is lacking on how much. The members of the Coordinating Committee on Multilateral Export Controls (COCOM) agreed to disband the group, and negotiations have proceeded on a more lenient regime to replace it. Those circumstances would seem to indicate that the budget for the EA could safely be cut. Concern remains, however, about the possible development of weapons of mass destruction by rogue governments in the developing world. That concern has been highlighted by the ongoing debate over the proper U.S. policy with regard to North Korea's nuclear program and the post-Persian Gulf War disclosures of Iraq's progress in developing and obtaining the technology and materials for nuclear, chemical, and biological weapons.

The Congress has been wrestling with the issue of updating U.S. export control law for five years. Funding levels for the EA and the resolution of that issue are inextricably linked. The EA's net budget authority for 1994 was reduced from its 1993 level by 15.3 percent, although outlays declined by only 6.3 percent because the agency carried over an unobligated balance from 1993. For 1995, the Administration has asked that budget authority be restored to slightly above the 1993 level. The 25 percent cut discussed above is an arbitrary figure chosen to illustrate the order of magnitude of budgetary savings that could be involved. The Congressional Budget Office has not judged whether, in fact, any of the updates of the law proposed over the past five years would make a 25 percent cut feasible.

DOM-21 ELIMINATE THE U.S. TRAVEL AND TOURISM ADMINISTRATION AND THE TRADE PROMOTION ACTIVITIES OF THE INTERNATIONAL TRADE ADMINISTRATION, OR CHARGE THE BENEFICIARIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	232	232	232	232	232	1,160
Outlays	163	209	232	232	232	1,068
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	242	251	261	271	281	1,306
Outlays	170	225	257	267	277	1,196

The United States Travel and Tourism Administration (USTTA) of the Department of Commerce promotes the United States as a tourist destination for foreign travelers. The International Trade Administration (ITA), also a part of the Commerce Department, has four direct program activities: the Import Administration, which investigates antidumping and countervailing-duty cases; the trade development program, which assesses the competitiveness of various U.S. industries and runs various export promotion programs; the international economic policy program, which develops policy, provides marketing services, and identifies and develops remedies for long-range trade and investment problems; and the U.S. and foreign commercial services, which counsel U.S. businesses on exporting. The latter three activities also help fight foreign barriers to U.S. exports. That effort, and perhaps the effort against foreign subsidies, may be necessary to maintain public support for free-trade policies, and in some cases they can be defended on economic grounds. The ITA's export promotion, marketing, and counseling could be eliminated, however, or the beneficiaries could be charged fees to pay more of the costs. The same holds true for the USTTA's activities.

Eliminating or charging firms for the cost of those activities would reduce outlays or increase receipts by $163 million in 1996 and by $1.1 billion over five years measured from the 1995 funding and receipt levels. It would reduce outlays or increase receipts by $170 million in 1996 and by $1.2 billion over five years measured from the 1995 levels adjusted for inflation.

One might argue that such activities are best left to the firms and industries involved rather than to the ITA and USTTA. Alternatively, one could argue that there may be some economies of scale to these activities, especially for small firms and less popular tourist destinations. If so, having one entity (the federal government) counsel exporters on foreign legal and other requirements, disseminate knowledge of foreign markets, and promote U.S. products and tourist destinations abroad could make sense. In that case, net federal spending could be reduced by charging the beneficiaries their full cost.

To the extent that the beneficiaries are not charged the full cost, the ITA's and USTTA's activities effectively subsidize the industries involved. Those implicit subsidies are an inefficient means of helping the industries because they are partially dissipated to foreigners in the form of lower prices for U.S. exports and for lodging and other tourist expenses. Because the current-account balance is determined by total saving and investment in the U.S. economy, over which the ITA and USTTA have no influence, the two agencies' activities do not improve the current-account balance. As a result of changes

they cause in exchange rates and other variables, all increases in exports and tourist expenditures resulting from the ITA's and USTTA's activities are completely offset by some mix of reduced exports of other industries and increased imports. Thus, other U.S. firms are hurt by the export and tourism promotion activities of these agencies.

DOM-22 ELIMINATE THE ADVANCED TECHNOLOGY PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	431	431	431	431	431	2,155
Outlays	77	207	358	431	431	1,504
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	445	460	477	493	511	2,386
Outlays	80	216	380	469	485	1,630

Eliminating the Advanced Technology Program (ATP) of the Department of Commerce would save \$1.5 billion in outlays over the next five years measured against the 1995 funding level and \$1.6 billion relative to the 1995 level adjusted for inflation. An alternative to eliminating the program is to return its funding to the 1993 level; that option would save \$1.3 billion in outlays over the 1996-2000 period relative to the 1995 funding level and \$1.4 billion relative to the 1995 level adjusted for inflation.

The objective of the ATP is to further the competitiveness of U.S. industry by helping convert discoveries in basic research more quickly into technological advancements with commercial potential. The Omnibus Trade and Competitiveness Act of 1988 established the ATP within the Commerce Department's National Institute of Standards and Technology. The program awards research and development (R&D) grants on the basis of merit to individual companies, independent research institutes, and joint ventures. The grants support research in generic technologies that have applications to a broad range of products, as well as precompetitive research (preceding product development).

The ATP's grants are limited to \$2 million when awarded to a single firm, but they have no limit when awarded to a joint venture. Participating firms and research organizations pay more than half of the R&D costs of each project, which acts as a check on a project's commercial viability. The program received its first appropriation \$10 million, in 1990; by 1994, its appropriation had grown to \$200 million. As of the end of 1993, the ATP had selected 89 projects and committed up to \$241 million in funding. The amount of funds committed more than doubled in 1994 as an additional \$307 million was awarded to 88 projects. It is too early to determine the commercial success of projects funded by the ATP because even after a project has ended, more research is required for product development and commercialization. According to a report by the General Accounting Office, as of September 1993, only four projects had ended (the ATP no longer funds them), and each was deemed successful in that the technology examined was found to be feasible. However, two of those projects are experiencing some difficulties with commercialization.

Opponents of the program argue that the near tripling of its funding between 1993 and 1994 (from \$68 million to \$200 million) could have lowered the average quality of winning R&D projects. Moreover, the Administration has proposed further dramatic increases over the next five years. If the applicant pool does not increase as dramatically as the program's funding, the award process is likely to be less competitive. An alternative that is sometimes mentioned is to return the funding of the program to its lower, 1993 level until the commercial success of some completed projects can be evaluated.

If the applicant pool does increase dramatically, the level of evaluation that occurs before an award is made may diminish. The National Institute of Standards and Technology, which runs ATP, faces an increase in its evaluation responsibilities with any expansion in the program. That increase is in addition to the institute's new responsibility for helping the Advanced Research Projects Agency within the Department of Defense oversee defense conversion projects (under the Technology Reinvestment Project).

Opponents of the ATP further question whether the federal government is capable of picking projects with the most potential for technological and commercial success. Furthermore, those projects that stand out as clear "winners" might have been funded by the private sector in any case. One privately funded study of the 11 projects supported by the first competition in 1990 suggests that as many as half of them would probably have been undertaken even without ATP support, although at a lower level of funding.

Proponents of the program maintain that firms do not invest enough in research on generic technologies because they cannot fully appropriate the benefits for themselves. (For example, generic technologies are likely to have applications to products developed later by firms that did not invest in the original research.) Because the incentive for firms to invest in this type of research is weak, say these advocates, producing less investment than is socially optimal, government support is desirable. In addition, the program's supporters cite evidence suggesting that the ATP encourages the formation of joint ventures, which increases cooperation among firms and between firms and academic institutions.

DOM-23 REDUCE FEDERAL AID FOR MASS TRANSIT

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority[a]	2,118	2,877	2,940	3,006	3,073	14,015
Outlays	475	920	1,349	1,640	1,912	6,296
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority[a]	2,154	2,951	3,054	3,161	3,272	14,592
Outlays	490	962	1,436	1,788	2,132	6,808

a. Budget authority includes mandatory contract authority specified in law.

In 1995, the principal federal transit assistance programs will provide about $3.7 billion in capital grants and about $8 billion in operating assistance to local mass transit agencies. Federal grants generally pay 80 percent of the costs of qualifying capital projects and offset up to 50 percent of local transit system operating deficits. In 1990, federal capital grants accounted for about 60 percent of all public capital spending for mass transit, and federal operating subsidies offset roughly 5 percent of the operating costs of transit systems nationwide (and about 9 percent of the systems' operating deficits). Reducing the federal share of qualifying investment costs for mass transit to 50 percent (and reducing funding by a corresponding amount) and eliminating operating assistance would save $475 million in 1996 and $6.3 billion over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $490 million in 1996 and $6.8 billion over the five-year period.

The large federal shares of investment spending and the subsidies for operating assistance appear to have had little effect on either transit productivity or the use of mass transit services. Despite modernization of transit systems, only 6.5 percent of journeys to or from work are made by mass transit. Transit agencies serve mainly downtown areas, whereas most of the growth in urban travel has been in the suburbs. At the same time, inflation-adjusted labor costs per mile of transit travel rose by 60 percent during the 1970s, when overall assistance levels were highest. Reducing the federal share of capital costs for mass transit might improve local investment choices, as a similar reduction seems to have done in the case of federal subsidies for construction of local wastewater treatment plants. Similarly, ending operating assistance could encourage local authorities to make better use of existing capital by improving services, using more cost-effective, smaller vehicles, or taking other steps to lower the operating costs of transit services.

Reducing federal transit subsidies, however, could harm some local transit services. The burden of diminished services would be borne disproportionately by people who are especially dependent on public transportation: the poor, the young, the elderly, and the disabled. Moreover, any reduction in transit service would occur just as the Clean Air Act of 1990 and the Intermodal Surface Transportation Efficiency Act of 1991 are placing increased pressure on states and localities to reduce their reliance on automotive transportation. Finally, an across-the-board cut in transit subsidies would be less efficient than targeted reductions, since certain transit investments, such as the rehabilitation of rail transit in older cities, could have a higher payoff.

DOM-24 ELIMINATE AIRPORT GRANTS-IN-AID

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority[a]	2,214	2,289	2,369	2,452	2,538	11,862
Outlays	261	870	1,174	1,320	1,392	5,017
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority[a]	2,214	2,289	2,369	2,452	2,538	11,862
Outlays	270	908	1,254	1,447	1,572	5,451

a. Budget authority is mandatory contract authority specified in law.

Each year, the Federal Aviation Administration (FAA) provides airports with grants for expanding capacity and improving terminals. About half of the grant money is apportioned by formula. The other half is considered discretionary, although the Congress has imposed some restrictions on its allocation. Over the past decade, about two-thirds of the funding has gone to primary, commercial service airports; about one-quarter has gone to general aviation and reliever airports; and the rest has been divided among other special programs. Eliminating those grants would result in savings of $261 million in 1996 and about $5.0 billion over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $270 million in 1996 and $5.5 billion over the five-year period.

Recent trends in aviation have increased the importance of larger airports (as measured by the number of embarking passengers). Those airports would have little trouble financing capital improvements from the fees collected or additional bonds issued if airport grants were eliminated. In 1991, the Congress passed legislation allowing airports to levy passenger facility charges (up to $3 per passenger). Those charges can supplement the revenues received from concessionaire rents, landing fees, and airline lease payments and, unlike federal grants, can be used to pay the interest on bonds issued by the airport. Passenger facility charges alone could bring in total annual revenues of about $1 billion to the 30 busiest airports. That revenue could be leveraged to support over $12 billion in borrowing.

Small reliever airports, financed by the FAA in the expectation that they would draw general aviation aircraft away from major airports, have not done so. Thus, some critics would argue against federal subsidies to those airports.

Supporters of the current program argue that the benefits provided by the system of airports are nationwide in scope. They also argue that more assistance is needed to overcome airport congestion and to allow airports to construct new gates and terminals that will promote competition among airlines, with benefits accruing to passengers.

DOM-25 ELIMINATE THE ESSENTIAL AIR SERVICE PROGRAM

	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
From the 1995 Funding Level						
Budget Authority[a]	39	39	39	40	41	198
Outlays	27	33	33	33	33	159
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority[a]	39	39	39	40	41	198
Outlays	28	35	37	38	39	177

a. Budget authority is mandatory contract authority specified in law.

The Essential Air Service (EAS) program was created by the Airline Deregulation Act of 1978 to continue air service to communities that had received federally mandated air service prior to deregulation. The program provides subsidies to air carriers serving small communities that meet certain criteria. Subsidies currently support air service to 82 communities, with about 700,000 passengers served annually. The subsidy per passenger ranges from $5 to nearly $320. The Congress has directed that such subsidies not exceed $200 unless the community is more than 210 miles from the nearest large or medium-size hub airport. (Separate rules apply to Alaska.)

Program outlays for 1994 were $32 million. If the program was eliminated, budgetary savings would be $27 million in 1996 and $159 million over the 1996-2000 period measured against the 1995 funding level, and $28 million in 1996 and $177 million over the 1996-2000 period measured against the 1995 level adjusted for inflation. To mitigate disruptions from eliminating the program, it could be phased out over several years. Total budgetary savings would depend on the speed of the phaseout.

Critics of the EAS program contend that the subsidies are excessive, providing air transportation at a high cost per passenger. They also state that the program was intended to be transitional and that the time has come to phase it out. Air transportation to small communities is not a vital part of the national transportation system. If states or communities derive benefits from such airline service, they could provide subsidies themselves.

Supporters of the subsidy program claim that it is necessary to prevent the isolation of rural communities that would not otherwise receive air service. The availability of airline transportation is an important ingredient in the economic development of small communities. Without continued air service, some towns might lose a sizable portion of their economic base.

DOM-26 ABOLISH THE INTERSTATE COMMERCE COMMISSION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	6	9	9	9	9	42
Outlays	5	9	9	9	9	41
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	6	10	11	11	11	49
Outlays	5	10	11	11	11	48

The Interstate Commerce Commission (ICC) regulates rates, operating rights, and mergers and acquisitions of interstate motor carriers and railroads. It also rules on rail abandonments and construction of new rail lines. The ICC's powers diminished after 1980, when the Motor Carrier Act and the Staggers Rail Act were passed, and its staff and budget decreased accordingly. But the vestiges of regulation remained, including a large number of routine applications for ICC approval of operating rights, rates, and other business decisions.

Last year, the Congress passed the Trucking Industry Regulatory Reform Act of 1994, which eliminates most tariff-filing requirements for motor carriers and relaxes standards for entry into the industry. The ICC's appropriation was reduced from nearly $45 million in 1994 to $30 million in 1995. The Congress also directed the ICC to review its statutory and regulatory responsibilities and to make recommendations for further reform. The ICC's report of its review recommends further reduction of motor carrier regulation but retention of most rail regulation.

Budgetary savings could be achieved by eliminating all remaining ICC regulation of motor carriers and transferring the ICC's current responsibilities for motor carrier safety to the Department of Transportation (DOT). Rail regulation could also be transferred to DOT. Those measures could save an estimated $5 million in 1996 and $41 million between 1996 and 2000 measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $5 million in 1996 and $48 million over the five-year period.

Proponents of transferring the ICC's remaining regulatory responsibilities to DOT argue that consolidating functions eliminates duplication of overhead expenses. It would also ensure conformity in safety and insurance regulation by housing oversight of all motor carriers in the same agency.

Opponents of transferring the ICC's responsibilities to DOT express several concerns. They worry that rail regulation would no longer be independent from the executive branch and would thus be more susceptible to political pressures. That problem could be mitigated by establishing an independent entity within DOT whose decisions about rail rates, routes, abandonments, and other economic issues would be insulated from the political process. Opponents also question the extent of the savings available if only the organizational structure is changed and not the underlying regulatory functions. Some express concern that a large organization like DOT might be more bureaucratic and less efficient than the ICC.

DOM-27 ELIMINATE FUNDING FOR HIGHWAY DEMONSTRATION PROJECTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority[a]	1,250	1,461	1,499	1,540	1,581	7,331
Outlays	94	436	675	855	1,004	3,063
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority[a]	1,262	1,485	1,536	1,591	1,646	7,519
Outlays	96	446	695	887	1,049	3,173

a. Budget authority includes mandatory contract authority specified in law.

For this option, the Congressional Budget Office assumes that the federal government will provide a total of $104.1 billion in contract authority for the Federal-Aid Highways Program during the 1996-2000 period. The states will obligate most of that money on highway projects of their own choosing. The Department of Transportation will distribute about $98.5 billion, or 95 percent of the total, according to broad statutory formulas and other procedures prescribed by law. The remaining $5.6 billion will be obligated for projects earmarked by the Congress in the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA). (ISTEA contains more than 500 separate projects.) In addition, the federal government will provide through the Federal Highway Administration $1.9 billion for various surface transportation demonstration projects during the five-year period. If the Congress amended ISTEA to eliminate contract authority for the demonstration projects contained in the bill and stopped funding surface transportation demonstration projects, it would lower the amount of budget authority by $7.3 billion and the amount of outlays by $3.1 billion over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, budget authority would be reduced by $7.5 billion, and outlays would be reduced by $3.2 billion over the five-year period.

Critics argue that, in many instances, demonstration projects cannot be justified by economic criteria. For example, a survey of demonstration projects authorized in the 1987 surface transportation bill found that about half of those projects did not appear in state transportation plans. More than 10 percent of the projects would not have qualified for funding under the regular highway grant programs. Funding for demonstration projects therefore encourages construction that neither state transportation officials nor the broader federal highway program regard as being of primary importance.

Those who favor demonstration projects argue that the projects reflect important needs that are not addressed sufficiently by the regular process of highway funding. For example, demonstration projects can provide economic aid for particular geographic regions or fund construction that involves costs or risks that are too great for individual states. Thus, ISTEA provides funding for projects that are intended, among other things, to accelerate the construction of high-cost bridges, demonstrate innovative techniques for highway construction and finance, and improve methods to relieve congestion. Formal studies of the benefits expected from individual projects, however, are rarely available, making it difficult to assess whether demonstration projects achieve their intended purposes.

DOM-28 ELIMINATE THE OPERATING SUBSIDY FOR AMTRAK

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	392	392	392	392	392	1,960
Outlays	392	392	392	392	392	1,960
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	405	419	433	449	464	2,170
Outlays	405	419	433	449	464	2,170

The federal government provides the National Railroad Passenger Corporation (also known as Amtrak) with subsidies of about $392 million a year for operating expenses, in addition to $150 million for mandatory passenger rail service payments, $230 million in capital grants, and $200 million for the Northeast Corridor Improvement Program. Eliminating the operating subsidy could result in savings of $392 million in 1996 and $2.0 billion over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $405 million in 1996 and $2.2 billion over the five-year period.

When the Congress established Amtrak in 1970, it expected to provide subsidies only for a limited time, until Amtrak could become self-supporting. Instead of declining, however, federal subsidies rose steadily in the 1970s, to nearly $1 billion in 1981. The Administration then proposed substantial cuts in federal funding. Amtrak subsequently raised fares and reduced costs, and subsidies have declined. Eliminating the operating subsidy would force Amtrak to intensify its efforts to cut costs and expand revenues.

Proponents of cutting subsidies argue that passenger rail service should compete on a level playing field with other modes of transportation--without the advantage of federal subsidies. Rail service in that case would have to become more efficient. Proponents also question the fairness of subsidizing the travel of business people, who make up a substantial share of Amtrak's passengers.

Opponents of cutting subsidies say that reducing federal support would lead Amtrak to cancel service on lightly traveled routes and that passengers in those areas might not have alternative transportation available. They also note that subsidizing rail service in congested areas may be justified as a way of offsetting the costs of congestion in travel by highway or air. Retaining federal subsidies for the Northeast Corridor Improvement Program may help to redress that imbalance. Finally, some Amtrak supporters claim that in the absence of operating subsidies, the entire system would have to shut down. If bankruptcy occurred, it is unclear what role the federal government would play in paying off Amtrak's liabilities, such as labor protection payments. In addition, because Amtrak contributes to the Railroad Retirement system, bankruptcy could hamper payments to current retirees. The estimates provided for this option do not include any potential impact for associated labor costs.

DOM-29 ELIMINATE THE LOCAL RAIL FREIGHT ASSISTANCE PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	17	17	17	17	17	85
Outlays	7	14	17	17	17	71
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	18	18	19	19	20	94
Outlays	7	14	18	19	20	78

Under the Local Rail Freight Assistance program, the Federal Railroad Administration provides grants to states for the rehabilitation of light-density tracks that are owned and operated by small railroads. Eliminating the program could save an estimated $7 million in 1996 and $71 million from 1996 through 2000 measured from the 1995 funding level, and an estimated $7 million in 1996 and $78 million over the five-year period measured from the 1995 funding level adjusted for inflation.

The rail lines receiving assistance generally serve small communities and act as feeders to major railroads. In many cases, the lines were once owned by large railroads, which sold them to smaller carriers because they were no longer profitable to the larger systems. On many occasions those sales occurred in part because of poor track conditions; rehabilitating the track would have cost more than it was worth to the major railroads.

Small railroads have been successful where larger railroads have not because the former usually have lower labor costs and greater flexibility to respond to the needs of shippers. The cost of rehabilitating track or of operating on poor-quality track, however, may make rail operations infeasible without subsidization.

Local rail freight assistance has not been included in the President's budget request since 1983, but the Congress has continued each year to fund the program. Opponents of the assistance argue that it is a low priority because the lines in question are not an important link in the national transportation system. They suggest that because most of the benefits accrue at the local or state level, any subsidies to be provided should come from state or local governments, not the federal government. At most, they might advocate the federal government's establishing a loan program, if it was shown that access to capital was limited as a result of market failures.

Supporters of the program claim that continued rail service to small communities provides substantial benefits. The fact that states, localities, and railroads provide matching funds indicates that they find the track improvement projects valuable. All projects are subject to benefit-cost analysis, and the relatively small amount of federal funding ensures that only the most worthwhile projects are undertaken.

DOM-30 ELIMINATE NASA'S SUPPORT FOR PRODUCERS OF COMMERCIAL AIRLINERS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	347	347	347	347	347	1,736
Outlays	184	323	347	347	347	1,548
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	359	371	384	397	411	1,921
Outlays	190	340	377	390	404	1,700

The National Aeronautics and Space Administration (NASA) funds the development of technology and systems intended for use in commercial airliners--both subsonic and supersonic--with the explicit objective of preserving the U.S. share of the current and future world airliner market. Eliminating NASA's Advanced Subsonic Technology and High-Speed Research programs would reduce outlays by $184 million in 1996 and $1.5 billion from 1996 through 2000 measured against the 1995 funding level. Measured against the 1995 level adjusted for inflation, outlays would be reduced by $190 million in 1996 and $1.7 billion from 1996 through 2000.

The large commercial aircraft industry is among the nation's most significant when measured by value of shipments, employment, or export sales. It has also been more profitable than the average manufacturing industry over the past several years. Two U.S. firms, Boeing and McDonnell Douglas, account for all of the nation's final sales of large commercial aircraft, but many other aerospace and nonaerospace businesses supply components to those firms. Along with the European-based Airbus Industrie, the two U.S. producers dominate the world market for large commercial aircraft (although McDonnell Douglas's share is significantly smaller and its profits lower than Boeing's).

NASA holds that the federal support offered in its Advanced Subsonic Technology Program--$125 million in 1995--is necessary to maintain the current U.S. share of the global market for subsonic aircraft. Among the key elements of the program are the testing of improved electronic controls and components under actual flight conditions and the developing and testing of new technologies that will allow the continued operation of aging jet aircraft. The High-Speed Research effort funded at $220 million in 1995 is a second conduit of support for the producers of commercial airliners. The program has two phases. Phase I is devoted to developing technologies that mitigate the atmospheric and noise effects of supersonic flight. Phase II, a cooperative venture with U.S. industry, is devoted to "high-leverage" technologies necessary for the economic viability of future supersonic commercial jet airplanes. NASA justifies the supersonic part of its aeronautical research and technology program the same way it justifies the program's subsonic component: the agency needs to support U.S. businesses that produce large commercial aircraft for the world market.

The case for eliminating federal support to U.S. producers of commercial airliners rests on the notion that the applied and systems-oriented research and development (R&D) necessary to maintain the U.S. market share is a private rather than a public responsibility. The owners and employees of aircraft companies benefit from success in the world market; accordingly, they should shoulder the burden of paying for the R&D necessary to produce better aircraft. The fact that the investments needed to develop, produce, and market a new commercial aircraft are very

large--$8 billion to $10 billion by some estimates--and the development of new aircraft requires many years should have little bearing on whether the public or private sector pays the cost of producing the necessary technologies.

Although a case can be made for federal support of R&D that ultimately benefits private businesses and is consistent with an economically efficient allocation of resources, it applies only weakly, or not at all, to the production of large aircraft. The benefits from the R&D supported by the NASA programs in question fall almost exclusively to aircraft manufacturers, their suppliers, and airlines. Left to their own devices, those parties should spend enough on the type of R&D supported by the NASA programs to leave society and themselves in the best position possible. Moreover, the type of research that is likely to be underfunded from society's point of view is supported by other NASA spending on aeronautical research and technology--$530 million in 1995.

The case for continued support of these programs is based largely on the unique competitive features of the market for large commercial aircraft. The United States and the European Union are parties to a bilateral agreement permitting public support for the development of commercial airliners. If the federal government failed to grant U.S. producers support comparable to that being provided by the governments of European competitors, opponents of this option would argue that U.S. producers would find themselves at a severe disadvantage in the global market.

A second argument for continuing NASA's expenditures on these programs is that limitations on noise levels and atmospheric pollutants impose an unfunded federal mandate on aircraft producers and airlines. Federal funds spent for research on noise and pollution abatement, as opposed to spending directed toward enhancing the economic viability of commercial aircraft, might be justified on the grounds that those funds cover a cost imposed on the industry by federal law. The force of that argument is diminished, however, to the extent that noise or atmospheric pollutants generated by jet air travel are unpaid "costs" that air travelers impose on the public at large. From that point of view, it is appropriate that aircraft producers, airlines, and, ultimately, air travelers pay the full social cost of their activities--including the cost of R&D that is directly applied to current and future jet aircraft.

DOM-31 ELIMINATE CERTAIN RURAL DEVELOPMENT PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Eliminate Direct Loans and Loan Guarantees						
From the 1995 Funding Level						
Budget Authority	202	202	202	202	202	1,010
Outlays	13	55	114	154	185	521
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	209	216	224	231	240	1,120
Outlays	13	57	121	166	203	560
Eliminate Grants						
From the 1995 Funding Level						
Budget Authority	561	561	561	561	561	2,805
Outlays	20	120	270	411	501	1,322
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	580	600	621	642	665	3,108
Outlays	21	125	284	440	548	1,418

NOTES: Programs include direct loans for rural development; direct loans and loan guarantees for water and waste disposal and for community facilities; loan guarantees for business and industry; and grants for water and waste disposal, rural development, fire protection, and solid waste management.

The figures in the table exclude savings in administrative costs.

The Department of Agriculture assists rural communities through a variety of programs, formerly administered by the Rural Development Administration (RDA). With the enactment of the Department of Agriculture Reorganization Act of 1994, the RDA has transferred its functions to the Rural Housing and Community Development Service, the Rural Utilities Service, and the Rural Business and Cooperative Development Service. In general, the programs provide loans, loan guarantees, and grants for rural water and waste disposal projects, community facilities, rural development, and fire protection. Funds are generally allocated among the states based on rural population and the number of rural families with income below the poverty threshold. Within each state, funds are awarded competitively to eligible applicants, including state and local agencies, nonprofit entities, and (in the case of loan guarantees for business and industry) for-profit organizations.

The amount of interest that loan applicants pay varies with the type of aid they receive and, in some programs, with the economic condition of the area. For example, for rural water and waste disposal loans, interest rates can range from 4.5 percent to market rates, depending on the median family income in the service area. If repayment of a loan would impose an undue financial burden on the residents of relatively poor areas, those areas may receive grants instead.

For 1995, the Congress appropriated $202 million in budget authority to support the costs of nearly $2 billion in combined direct loans and loan guarantees. Under credit reform, those costs include the present value of interest subsidies and the cost of loans that go into default. In addition, the Congress appropriated $561 million for grants, of which $500 million is for water and waste disposal. Eliminating the loan programs would reduce federal outlays for subsidizing direct loans and loan guarantees by $521 million over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $560 million over the same period. Additional savings would be realized gradually as the costs of administering a shrinking portfolio decreased. Measured from the 1995 funding level, savings in outlays from eliminating grants would total about $1.3 billion from 1996 through 2000; adjusted for inflation, savings would be $1.4 billion.

One argument for terminating these programs is that federal funds should be directed toward activities whose benefits are national in scope, with state and local governments funding rural development. Moreover, studies completed by the General Accounting Office and the Center for Community Change found that two of the largest programs--the water and waste disposal program and the business and industry guaranteed loan program--are not well targeted toward low-income or distressed communities. Communities with higher incomes or lower unemployment (or both), the studies found, were more likely to receive assistance than communities with low incomes or higher unemployment.

Supporters of federal funding of rural development programs argue that, by sparking economic growth, the programs help to increase rural incomes. Eliminating these funding sources would probably reduce economic development activities because private credit simply may not be available in some areas and many fiscally distressed states and localities would be unable to offset the loss of federal grants and interest subsidies.

DOM-32 ELIMINATE THE ECONOMIC DEVELOPMENT ADMINISTRATION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	440	440	440	440	440	2,200
Outlays	41	126	240	330	419	1,156
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	455	471	488	505	522	2,441
Outlays	43	132	255	356	462	1,248

The Economic Development Administration (EDA), an agency within the Commerce Department, provides grants to state and local governments for public works, technical assistance, defense conversion activities, and job programs, as well as loan guarantees to firms for business development. For 1995, appropriations for EDA programs total $440 million. Disbanding the EDA would reduce federal outlays by about $41 million in 1996 and $1.2 billion over the 1996-2000 period measured against the 1995 funding level. Measured against the 1995 level adjusted for inflation, savings would be $43 million in 1996 and $1.2 billion over the five-year period.

One criticism of EDA programs is that federal assistance should not be provided for activities whose benefits are primarily local and which therefore should be the responsibility of state and local governments. In addition, EDA programs have been criticized for substituting federal credit for private credit and for facilitating the relocation of businesses from one distressed area to another through competition among communities for federal funds. The EDA has also been criticized for its broad eligibility criteria, which allow areas containing 80 percent of the U.S. population to compete for benefits, and for providing aid with little proven effect compared with other programs having similar goals. Furthermore, because of the competitive nature of EDA programs, local governments do not incorporate this type of aid into their budget plans; hence, eliminating future EDA funding would not impose unexpected hardships on communities.

Some of the reduction in aid associated with this option would, however, curtail economic development activities in financially distressed communities that have no other available resources. That cutback could result in the deterioration of infrastructure, the loss of prospective jobs, and decreases in local tax receipts in those areas.

DOM-33 ELIMINATE THE APPALACHIAN REGIONAL COMMISSION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	282	282	282	282	282	1,410
Outlays	14	85	169	219	254	741
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	291	301	312	323	334	1,561
Outlays	15	88	178	236	280	797

The federal government provides annual funding to the Appalachian Regional Commission (ARC) for activities that promote economic growth in the Appalachian counties of 13 states. For 1995, the Congress appropriated $282 million for the ARC. The states are responsible for filing development plans and for recommending specific projects for federal funding. The commission distributes the funds competitively, based on such factors as the area's growth potential, per capita income, and rate of unemployment; the financial resources of the state and locality; the prospective long-term effectiveness of the project; and the degree of private-sector involvement.

The ARC supports a variety of programs, including the Appalachian Development Highway System, to open up areas with development potential; the Community Development Program, primarily to create jobs; the Human Development Program, to improve rural education and health; and the Research and Local Development District Programs, to provide planning and technical assistance to multicounty organizations. Federal funds also support 50 percent of the salaries and expenses of the ARC staff. Discontinuing the programs funded through the ARC would reduce federal outlays by $14 million in 1996 and by $741 million over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $15 million in 1996 and $797 million over the five-year period.

Those in favor of termination argue that the programs supported by the ARC duplicate activities funded by other federal agencies, such as the Department of Transportation's federal highways program and the Department of Housing and Urban Development's Community Development Block Grant program. Critics of the ARC also contend that although it allocates resources to poor rural communities, those areas are no worse off than many others outside the Appalachian region and therefore no more deserving of special federal attention.

Nevertheless, eliminating federal funding of the ARC programs would reduce economic development activities in the region, because the fiscal distress of many states and localities would probably preclude their offsetting that loss of resources. Thus, fewer jobs might be created, and rural infrastructure, education, and health care conditions might suffer in this area of the country.

DOM-34 ELIMINATE OR RESTRICT COMMUNITY DEVELOPMENT BLOCK GRANTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Eliminate the CDBG Program						
From the 1995 Funding Level						
Budget Authority	4,600	4,600	4,600	4,600	4,600	23,000
Outlays	184	2,024	3,864	4,508	4,600	15,180
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	4,752	4,913	5,088	5,262	5,446	25,461
Outlays	190	2,097	4,069	4,876	5,141	16,373
Restrict Eligibility and Reduce Funding						
From the 1995 Funding Level						
Budget Authority	920	920	920	920	920	4,600
Outlays	37	405	773	902	920	3,037
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	950	983	1,018	1,052	1,089	5,092
Outlays	38	419	814	975	1,028	3,274

The Community Development Block Grant (CDBG) program provides annual grants, by formula, to eligible metropolitan cities and urban counties through what is referred to as its entitlement component. Under the formula, jurisdictions with greater needs (as measured by factors such as population, poverty levels, and housing conditions) receive larger grants than those with lesser needs. The program also allocates funds, by formula, to each state. The latter funds are distributed among nonentitlement areas, typically through a competitive process. Nonentitlement areas generally are units of local government that have populations under 50,000 and that are not metropolitan cities or parts of urban counties.

Community Development Block Grants in general must be used to aid low- and moderate-income households, to eliminate slums and blight, or to meet emergency needs. In accomplishing those goals, they may be used for a wide range of community development activities, including rehabilitation of housing, improvement of infrastructure, and economic development. Funds from the entitlement component may also be used to repay principal and interest on obligations that are issued by local governments to finance certain activities--such as the acquisition or rehabilitation of public property--and that are guaranteed by the federal government under the Section 108 loan guarantee program.

For 1995, the appropriation for the CDBG program amounts to $4.6 billion. Of that total, $3.2 billion is allocated to metropolitan cities and urban counties and $1.3 billion goes to nonentitlement government units; the remainder is earmarked for specific purposes described in the appropriation act. Substantial federal savings could be realized either by terminating the CDBG program or by restricting eligibility for the entitlement component to exclude the least needy jurisdictions while reducing funding levels. Least needy jurisdictions could be defined by measuring relative economic well-being and fiscal

capacity using factors such as the number and percentage of families below the poverty level and per capita income.

Eliminate the CDBG Program. If the CDBG program was eliminated, savings in federal outlays would amount to around $184 million in 1996 and a total of $15.2 billion over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $190 million in 1996 and $16.4 billion over the five-year period.

One argument for terminating the program is that federal funds should be targeted toward programs whose benefits are national rather than local. Accordingly, programs such as the CDBG program, which generate primarily local benefits, should be funded by state and local governments. Moreover, to the extent that local jurisdictions use CDBG funds to help them compete against each other to attract business, benefits are shifted away from local jurisdictions to private firms. Without the CDBG program, however, a number of its activities would not be undertaken by most local governments--particularly the rehabilitation of low-income housing and, to some extent, economic development. Since the CDBG program is the largest source of federal aid for many cities, fewer resources would be available for low-income households. Furthermore, CDBG funding has presumably been figured into the budgets of entitlement recipients. Ending that support could impose at least temporary stress on many governments, some of which continue to experience fiscal difficulties.

Restrict Eligibility and Reduce Funding. If the entitlement component of the program was cut by 20 percent, federal outlays could be reduced by $37 million in 1996 and $3 billion over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, savings would be $38 million in 1996 and $3.3 billion over the five-year period. One way of achieving such a cut would be to eliminate funding for a sufficient number of the least needy jurisdictions. A cutback of that kind would effectively increase the proportion of funds going to the nonentitlement component from 30 percent to 35 percent, but the typically competitive nature of the distribution process would presumably ensure that those funds would be targeted toward the neediest areas. Carrying out this option would require both a change in the authorizing legislation and a cut in the program's annual appropriation.

An argument in favor of such a cutback is that no pressing interest is served by supporting jurisdictions that have above-average ability to fund projects themselves. For example, 15 of the 20 counties that had the highest per capita income in the nation in 1989 received funds in 1993 under the CDBG entitlement component. Eliminating funding for those types of jurisdictions, rather than reducing grants across the board, would ensure that the most distressed jurisdictions retained the same level of aid. However, a reduction in federal funds for affluent jurisdictions would probably curtail activities designed to aid low- and moderate-income households in any pockets of poverty in those areas, because local governments would probably not completely offset the reduction.

DOM-35 ELIMINATE FEDERAL SUPPORT FOR TENNESSEE VALLEY AUTHORITY ACTIVITIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	143	143	143	143	143	715
Outlays	42	117	133	143	143	578
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	148	153	159	164	170	794
Outlays	43	123	144	159	165	634

The Tennessee Valley Authority (TVA) is a federal agency that operates an electric utility with billions of dollars in annual sales. It is also charged with "planning for the proper use, conservation, and development of the natural resources of the Tennessee River drainage basin." The annual federal appropriation for the TVA supports its stewardship of lands, facilities, and natural resources (including maintaining a system of dams and reservoirs), its recreational programs and environmental research center, and its efforts to assist local economic development and promote public use of its land and water resources.

In 1995, the TVA anticipated spending $258 million on those non-power-generating activities, financed by $140 million from federal appropriations, $93 million from reimbursements for services provided to other federal agencies, $18 million from purchasers of TVA electricity, and $6 million from other sources. Eliminating the activities that the annual appropriation supports, except those activities whose costs could be shifted to nonfederal sources, would reduce federal outlays by about $42 million in 1996 and $578 million over the 1996-2000 period measured from the 1995 funding level. Measured from the 1995 level adjusted for inflation, outlays would be reduced by $43 million in 1996 and $634 million over the five-year period.

In recent years, the TVA has used the largest chunk of its appropriation to fund its stewardship program. Eliminating federal support for that program accounts for roughly half of the total savings in this option. The main argument for cutting that funding is that stewardship activities should be financed regionally by state and local governments or by charging fees to their beneficiaries--or discontinued if they are insufficiently valuable. Proponents of maintaining federal funding note that the TVA has a federally mandated mission to promote the proper use, conservation, and development of the region's natural resources as well as its economic well-being. They also argue that some stewardship benefits, such as reductions in flood crests and improvements in ecological stability, are distributed very broadly or accrue in part to future generations. Funding the activities underlying those benefits through fees levied on the beneficiaries is therefore difficult.

A quarter of the savings in this option come from eliminating funding for TVA's Environmental Research Center in Muscle Shoals, Alabama. Past research at the center (formerly, the National Fertilizer and Environmental Research Center) developed 75 percent of the fertilizers in use today. The center's current program includes research in ozone mitigation, pollution-free agriculture, use of poultry litter, utility waste management, and biotechnology for cleaning up hazardous wastes.

Critics of the center argue that many of its research projects benefit the private sector and that other projects should be consolidated with research being conducted by the Department of Agriculture or

the Environmental Protection Agency. Supporters of continued funding note that the center has eliminated two-thirds of its projects (including fertilizer research and development) and increased its use of external funding from other federal agencies and the private-sector Electric Power Research Institute. They also argue that the center is uniquely positioned to develop solutions that reflect a large region's environmental, economic, and social needs.

The remaining savings projected from this option result from withdrawing federal funding for the TVA's programs in recreation, promotion of land and water resources, and local economic development. The broad argument against federal funding of those programs is that their benefits are largely regional. Funding should therefore be provided by state or local governments or through fee-for-service mechanisms. Supporters of continued funding again point to the TVA's federally mandated mission and to the difficulty that state and local governments could have in apportioning the costs of collectively valuable programs in the absence of federal funding.

DOM-36 CONSOLIDATE AREA OFFICES OF THE BUREAU OF INDIAN AFFAIRS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	27	27	27	27	27	135
Outlays	19	27	27	27	27	127
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	28	29	30	31	32	150
Outlays	19	27	28	29	30	133

The Bureau of Indian Affairs (BIA) currently has 12 area offices that serve the federally recognized tribes located within their geographic regions. Area offices employ 9 percent of the BIA workforce and coordinate child protection programs, financial trust services, and technical assistance. They also process loan and grant applications, negotiate and award self-determination contracts, and provide administrative support. This option would halve the number of area offices from 12 to 6, saving $19 million in 1996 and $127 million from 1996 through 2000 measured from the 1995 funding level. Savings from the 1995 level adjusted for inflation would be $19 million in 1996 and $133 million from 1996 through 2000.

Reducing the number of area offices would accord with the desire of tribal organizations to decentralize decisionmaking authority. As the office's role is redefined to comprise advising and assisting field offices and tribal organizations rather than implementing programs, fewer will be needed. Such a reduction would also be in line with the current trend toward self-determination among the tribes: many of them are opting, either by themselves or through outside contracting, to provide services that were once supplied by the BIA. The reduction fits in with BIA objectives as well, as the agency works to meet the goals of the National Performance Review by cutting personnel by 50 percent in its central and area offices. Indeed, the BIA will face serious gaps in its ability to deliver services unless its area offices are consolidated.

The current Secretary of the Interior, however, has made a firm commitment to allow the BIA to use any savings from personnel cuts after 1995 to allocate more of its funding directly to the tribes and for training providers of technical assistance and services at the "front line." Such training is necessary to help tribes to assume greater responsibility for such programs. Therefore, if the Secretary fulfills his commitment, the savings from eliminating offices would not be used to reduce the deficit. Another potential drawback to this option is that the cut from 12 to 6 area offices may diminish oversight at that level, which may be needed especially as tribal organizations move further into self-determination of their activities. The tribes, for their part, view the reduction with some concern: despite their desire for decentralized decisionmaking authority, they fear that consolidating area offices would be a first step toward losing their current government-to-government relationship with the United States.

DOM-37 ELIMINATE FUNDING TO SCHOOL DISTRICTS FOR IMPACT AID

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	728	728	728	728	728	3,640
Outlays	600	710	728	728	728	3,494
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	750	780	810	830	860	4,030
Outlays	615	760	800	830	855	3,860

Impact Aid (previously known as School Assistance in Federally Affected Areas) is intended to compensate school districts affected by activities of the federal government. Payments are made to districts for federally connected pupils and for school construction in cases in which the federal government has acquired a significant portion of the district's real property tax base, thereby depriving the district of a source of revenue.

Impact Aid goes to school districts having a minimum of 3 percent (or at least 400) of their pupils associated with activities of the federal government, including pupils whose parents both live and work on federal property (Indian lands are part of that designation); pupils whose parents are in the uniformed services but live on private property; and pupils who live in low-rent housing that is federally subsidized. In addition, aid goes to a few districts enrolling at least 2,000 pupils (and 15 percent of enrollment) whose parents work on federal property. In 1993, Impact Aid went to approximately 2,500 school districts spread across all of the states. As a result of the program's reauthorization in 1994 (as title VIII of the Elementary and Secondary Education Act of 1965, as amended), Impact Aid is likely to be more targeted in the future toward pupils whose parents live and work on federal land. Because of hold-harmless provisions, however, most school districts will not be fully affected by the changes in the law until 1997.

Eliminating all funding for Impact Aid would reduce federal outlays in the 1996-2000 period by about $3.5 billion measured from the 1995 funding level and about $3.9 billion measured from the 1995 funding level adjusted for inflation. Proponents of eliminating the program argue that the economic benefits from federal activities outweigh the demands placed on the schools, making Impact Aid unnecessary. Those economic benefits are considered so substantial that local jurisdictions compete vigorously for new federal activities and lobby intensely to forestall losing existing ones. Opponents counter that the presence of federal activities does not adequately compensate local governments and school districts for losses in property tax revenues. (Additional revenues resulting from federal activities are collected primarily by the state through income and sales taxes.) Moreover, some school districts--especially isolated ones that have military installations with large numbers of children residing on federal property--would face severe financial hardship if such funding was eliminated.

DOM-38 ELIMINATE ANCILLARY VOCATIONAL EDUCATION PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Eliminate Community-Based Organizations Programs						
From the 1995 Funding Level						
Budget Authority	9	9	9	9	9	45
Outlays	1	8	9	9	9	36
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	10	10	10	11	11	52
Outlays	1	8	10	10	11	40
Eliminate the Consumer and Homemaking Education Program						
From the 1995 Funding Level						
Budget Authority	35	35	35	35	35	175
Outlays	5	25	35	35	35	135
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	35	35	40	40	40	190
Outlays	5	25	35	40	40	145

Vocational education--occupationally specific instruction in such areas as business math, industrial arts, electronics, and office management--is widely offered in U.S. secondary schools. Federal legislation in the form of the Carl D. Perkins Vocational and Applied Technology Education Act is intended to help states ensure equal vocational education opportunities for traditionally underserved populations. The act also funds qualitative improvements in vocational education programs in order to increase workforce productivity and promote economic growth. In addition to its core programs, this legislation established other programs that are ancillary to its larger purposes, such as the Community-Based Organizations programs and the Consumer and Homemaking Education program. Eliminating them would probably not affect the accomplishment of the central purposes of the legislation and over the 1996-2000 period could save $171 million measured from the 1995 funding level and $185 million measured from the 1995 level adjusted for inflation.

Eliminate Community-Based Organizations Programs. These programs fund projects that include outreach efforts to locate likely recipients of vocational education; prevocational basic-skills training, guidance, and counseling; and career intern programs. In 1994, 53 grants were made to states and outlying areas for $12 million; most states then used competitive grants to fund local recipients. Eliminating these programs could save $36 million in outlays measured from the 1995 funding level and $40 million measured from the 1995 level adjusted for inflation.

People who argue for eliminating these programs have several criticisms. The services the programs fund are ancillary to vocational education in that they do not address the allocation or quality of occupationally specific instruction. In some cases, the services only supplement those funded by other sources. States tend to distribute funds among a large number of organizations located in different parts of the state,

and many awards appear to be too small to make a significant difference. Furthermore, most states do not conduct formal evaluations of the projects they fund.

Proponents of the programs argue that they complement the efforts of the core Vocational Education Basic Grant program. For example, they fund efforts to reach disadvantaged individuals who may not be served by regular vocational education programs; those people include school dropouts, substance abusers, teenage parents, and immigrants with limited language skills. The services offered through community-based organizations can also provide beneficiaries with the attitudes and basic skills they need to succeed in mainstream vocational education programs.

Eliminate the Consumer and Homemaking Education Program. This program provides grants to states to prepare youths and adults to be homemakers. Federal funds are allocated according to a state's per capita income and population; one-third of each state's allotment must go to economically depressed areas. These funds can be used for instruction in family living and parenthood, food preparation and nutrition, child development and guidance, home management, and the like. In 1994, $35 million was appropriated for this program, and 53 grants were made to the states, the District of Columbia, and outlying areas. Eliminating the program would reduce federal outlays over the 1996-2000 period by $135 million measured from the 1995 funding level and $145 million measured from the 1995 level adjusted for inflation.

Critics of the Consumer and Homemaking Education program argue that there is no essential federal role in educating people to be homemakers and that federal funds are not necessary to support these activities. Federal funds generally supplement state and local programs for elementary and secondary schools, where state and local dollars have exceeded federal dollars by more than 20 to 1. If they chose, states and localities could use funds from their Basic Grants to States to continue those services.

Proponents of the program see it as an important supplement to efforts to reduce sex bias and stereotyping in family life. The program also provides funds for ancillary services (including outreach) to ensure the quality and effectiveness of local programs. Without federal support, local consumer and homemaking education services might be restricted or reduced in quality.

DOM-39 ELIMINATE 30 SMALL GRANT PROGRAMS IN THE DEPARTMENT OF EDUCATION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	187	187	187	187	187	935
Outlays	32	143	183	187	187	732
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	195	200	205	215	220	1,035
Outlays	30	150	195	205	215	795

The Department of Education funds more than 230 programs that address a range of problems at all levels of education. Some analysts have argued that a number of those programs have either largely or completely achieved their original purposes or could be supported by other funding sources. The National Performance Review (NPR) recommended that 34 such programs be eliminated, and the Congress did eliminate 12 of them. Among the remaining programs on the NPR list are 13 relatively small programs that are not considered elsewhere in this volume. Another 17 programs in the Department of Education are each funded at $15 million or less in 1995. These 30 programs range in cost from about $125,000 to $30 million a year. Eliminating all of them would save, over the 1996-2000 period, $732 million measured from the 1995 funding level and $795 million measured from the 1995 level adjusted for inflation.

NPR Terminations. The Congress appropriated $130 million in 1995 for the 13 programs that the NPR recommended terminating. Eliminating those programs would reduce federal spending over the 1996-2000 period by $500 million measured from the 1995 funding level and by $545 million from the 1995 level adjusted for inflation.

These 13 grant programs vary in size and serve a wide range of purposes. The largest one--the Dropout Prevention Demonstrations--received almost $30 million in 1995. The smallest is the Eisenhower Leadership Program, which gets about $4 million in funding. Other programs include several small ones for libraries, Ellender Fellowships (a grant to the Close Up Foundation to bring economically disadvantaged people to Washington, D.C., to increase their understanding of the federal government), Cooperative Education (grants for programs that alternate periods of academic study and employment), Education for Native Hawaiians, and Civics Education.

The NPR recommended terminating these programs because they duplicate others, have achieved their purposes, or are more appropriately supported with nonfederal funds. The Department of Education had already suggested eliminating them, and the Administration's proposed budget for 1995 had so recommended. Opponents of this option argue that many of the programs have been successful in addressing the specific problems for which they were created but are still needed because the underlying conditions continue to exist. Advocates also point out that alternative funding from local and state governments or private sources would probably not be forthcoming if the federal programs were eliminated.

Other Small Programs. The Congress appropriated about $60 million in 1995 for the 17 additional programs considered here that had annual spending of $15 million or less. Eliminating those programs would reduce federal spending over the 1996-2000 period by $230 million measured from the 1995

funding level and by $250 million measured from the 1995 level adjusted for inflation.

These 17 programs are all small and support a range of projects. The largest program, the National Diffusion Network (which disseminates education practices, products, and programs developed by school districts, colleges, and other organizations), received $15 million in 1995. The next largest program, Parental Assistance, was a new program in 1995 and got $10 million. The other 15 programs were all funded at less than $6 million--12 of them were new in 1995.

Proponents of eliminating these programs argue that the projects supported by them are generally too small to be effective on a national scale, duplicate other efforts across the nation, or could be funded from other federal programs. Many of the programs might also obtain funding from foundations or other nonfederal sources. Opponents of eliminating them argue that many of these programs are intended to demonstrate the effectiveness of imaginative ideas that could later be adopted by other schools, districts, or states. They also note in particular that the National Diffusion Network has fostered the adoption of effective educational practices across the country and argue that the federal government has a natural role in disseminating information about useful innovations in education.

DOM-40 REDUCE FUNDING FOR ELEMENTARY AND SECONDARY EDUCATION PROGRAMS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	7,419	7,419	7,419	7,419	7,419	37,095
Outlays	1,189	5,890	7,234	7,419	7,419	29,151
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	7,910	8,430	8,995	9,560	10,150	45,045
Outlays	1,265	6,365	8,215	8,955	9,525	34,325

About $300 billion will be spent educating children in elementary and secondary schools in this country in school year 1994-1995. The federal share of that total is expected to be about 7 percent, or over $20 billion. The largest federal programs funded through the Department of Education are Title I of the Elementary and Secondary Education Act, which funds services for economically and educationally disadvantaged students; Impact Aid, which compensates school districts affected by certain federal activities; the Individuals with Disabilities Education Act, which funds services for disabled students; and the Perkins Vocational and Applied Technology Education Act, which funds vocational education.

Because the federal contribution to elementary and secondary education is relatively small, some analysts have suggested that funding for such programs in the Department of Education be decreased to help reduce federal spending (see, for example, DOM-37, DOM-38, and DOM-39). Over the 1996-2000 period, holding funding for those programs at 50 percent of the 1995 funding level would save about $29 billion measured from the 1995 funding level and about $34 billion measured from the 1995 level adjusted for inflation. This option would reduce the appropriation by nearly 60 percent, in real terms, in the fifth year.

If the funding for these programs was reduced, the Congress might also consider modifying them to enhance the flexibility of state and local governments in adjusting to those decreases. One possible change would be to fold the programs into a block grant that specified purposes for which the funds could be spent but left decisions about how to use the funds to the states and the school districts. Since some of the programs are associated with federal mandates regarding services that children must receive (for example, for disabled students), the Congress might also want to modify those mandates.

The primary argument in favor of this proposal is that the federal government cannot afford to fund these programs at their current levels. If funding was reduced, state and local governments might offset some of the cuts to the extent that they found the programs useful or required by federal mandates. Enhancing the flexibility of states and school districts in adjusting to possible cuts could reduce some of the negative consequences of reductions in funding.

The main argument for maintaining funding for these programs is that the effects of cuts would be concentrated among the special populations of students that the programs serve. Those populations include students with one or more of the following characteristics: economically and educationally disadvantaged, limited proficiency in English, disabled, Indian (Native American) origin, and in vocational education. Because states and school districts are unlikely to be able to offset all of the reductions in federal funds, services for students in those categories would probably be reduced.

DOM-41 ELIMINATE STATE STUDENT INCENTIVE GRANTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	63	63	63	63	63	315
Outlays	13	63	63	63	63	265
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	65	70	70	70	75	350
Outlays	15	65	65	70	75	290

The State Student Incentive Grant (SSIG) program helps states provide financially needy postsecondary students with grant and work-study assistance while they attend academic institutions and schools that provide occupational skills. States must match federal funds at least dollar for dollar, while also meeting maintenance-of-effort criteria. Unless excluded by state law, all public and private nonprofit postsecondary institutions in a state are eligible to participate in the SSIG program. In 1994, the federal government appropriated $72 million, which was matched by 50 states and seven other jurisdictions; the money was distributed to an estimated 240,000 students.

During the 1996-2000 period, eliminating SSIGs would save the taxpayers $265 million measured from the 1995 funding level and $290 million measured from the 1995 level adjusted for inflation. If a portion of the resulting savings from eliminating this program was redirected to the Federal Pell Grant Program, which assists financially needy undergraduates, some of the adverse effects of eliminating SSIGs could be alleviated. In either case, the extent of the actual reduction in assistance would depend on the responses of states, some of which would probably make up part of the lost federal funds.

Proponents of eliminating this program argue that it is no longer needed to encourage states to provide more student aid. When the SSIG program was authorized in 1972, only 31 states had student grant programs; now, all 50 states provide student grants. Furthermore, state need-based aid for undergraduates increased from $1.1 billion (in 1994 dollars) in academic year 1973-1974 to an estimated $2.2 billion in academic year 1993-1994, when about 1.6 million students received such aid.

Opponents of eliminating SSIGs argue that not all states would increase their student aid appropriations to make up for the lost federal funding and some might even reduce them. In that case, some students receiving less aid might not be able to enroll in college or might have to attend a less expensive school. Eight states just met the SSIG matching provision in academic year 1991-1992.

DOM-42 ELIMINATE FEDERAL FUNDING FOR CAMPUS-BASED STUDENT AID

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Eliminate Campus-Based Aid						
From the 1995 Funding Level						
Budget Authority	1,358	1,358	1,358	1,358	1,358	6,790
Outlays	135	1,315	1,358	1,358	1,358	5,524
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	1,400	1,450	1,500	1,555	1,610	7,515
Outlays	140	1,365	1,455	1,505	1,555	6,020
Eliminate Campus-Based Aid and Redirect Half of the Savings						
From the 1995 Funding Level						
Budget Authority	679	679	679	679	679	3,395
Outlays	0	652	679	679	679	2,689
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	725	770	820	875	930	4,120
Outlays	5	700	775	825	880	3,185

The federal government provides campus-based student aid through three programs: Supplemental Educational Opportunity Grants, Perkins Loans (formerly National Direct Student Loans), and Work-Study. Financial aid administrators at postsecondary institutions determine which eligible students receive aid under general federal guidelines. In 1995, the federal government provided $1.4 billion in campus-based aid, which will go to approximately 1.6 million students.

Eliminating federal funding for these programs would lower outlays from the 1995 funding level by $5.5 billion during the 1996-2000 period. The savings from the 1995 funding level adjusted for inflation would be $6.0 billion over that period. Alternatively, half of the savings from eliminating those programs could be redirected to the Federal Pell Grant Program, which is more closely targeted toward low-income students. The extent of the reduction in total student aid would depend on the responses of postsecondary institutions, some of which would make up part or all of the lost federal funds. Moreover, since postsecondary institutions retain about $6.1 billion in revolving funds under the Perkins Loan program, an estimated 572,000 students would receive loans, averaging about $1,340 in 1995, even if the federal government did not fund any new campus-based aid.

The primary justification for this option reflects the view that the main goal of federal student aid is to provide access to postsecondary education for people with low income. Because campus-based aid is tied to specific institutions, students with greater need at poorly funded schools may receive less than those with less need at well-funded institutions.

Postsecondary institutions object to this option, however, because it would reduce their discretion in packaging aid to address the special situations of some students while also reducing total available aid.

Moreover, these programs disproportionately help students at private, nonprofit institutions (whose students get over 40 percent of this aid, compared with about 20 percent of Pell Grant aid). Thus, cutting campus-based aid would make this type of school less accessible to needy students.

Redirecting half of the savings from eliminating campus-based aid to the Pell Grant program would mitigate the effects on lower-income students of less total aid. The Pell Grant appropriation provides for a maximum award of $2,340 in the 1995-1996 academic year. Redirected funds from campus-based programs could be used by the appropriations committees to increase the maximum Pell grant. Pell grants allow students to choose freely among postsecondary institutions rather than be limited to institutions that offer them campus-based aid. Redirecting one-half of the funds to the Pell Grant program would, however, result in about one-half of the savings that could otherwise be gained by eliminating campus-based aid.

DOM-43 REDUCE FUNDING FOR THE JOB TRAINING PARTNERSHIP ACT'S YOUTH TRAINING PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
			From the 1995 Funding Level			
Budget Authority	270	270	270	270	270	1,370
Outlays	10	260	270	270	270	1,080
			From the 1995 Funding Level Adjusted for Inflation			
Budget Authority	290	310	330	350	380	1,660
Outlays	10	270	310	330	350	1,270

Under title II-C of the Job Training Partnership Act (JTPA), state and local agencies receive grants to provide work-related assistance to economically disadvantaged youth under age 22. The assistance includes classroom and on-the-job training, help with job searches, remedial education, and supportive services. The Department of Labor estimates that over 300,000 young people will receive aid in program year 1994. The appropriation for this program was reduced by about 10 percent for 1995. The Administration had proposed that reduction in response to an evaluation that found that the program had not increased the earnings of its participants.

Holding the appropriation for this program at 50 percent below the 1995 funding level would save, over the 1996-2000 period, $1.1 billion measured from the 1995 funding level and $1.3 billion measured from the 1995 level adjusted for inflation. This option would reduce the appropriation by about 60 percent, in real terms, in the fifth year. The main argument for cutting the program is that it does not appear to be working, at least for out-of-school youth. In a time of fiscal stringency, ensuring that scarce resources are not dissipated on ineffective programs is especially critical. Other programs are available for some of the young people who otherwise would have participated in this program.

Yet the importance of preparing youth from low-income families with the skills they need to be productive workers is not diminished by the findings from the evaluation of the JTPA program. Thus, an argument in favor of maintaining current funding is that people who run the program on the local level could work on enhancing the program's effectiveness. Moreover, the Department of Labor has already taken steps that it believes will improve the program.

An alternative approach would be to use some of the savings attained by reducing the appropriation for this program to increase the appropriations for other programs for economically disadvantaged youth. That approach, of course, would achieve a smaller reduction in total spending unless a larger cut in the appropriation for the youth training program was made.

DOM-44 ELIMINATE THE SENIOR COMMUNITY SERVICE EMPLOYMENT PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	410	410	410	410	410	2,060
Outlays	70	380	410	410	410	1,680
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	420	440	450	470	490	2,270
Outlays	80	390	440	460	470	1,840

The Senior Community Service Employment Program (SCSEP) funds part-time jobs for people age 55 and older who are unemployed and who meet income eligibility guidelines. Through SCSEP, which is authorized under title V of the Older Americans Act, grants are awarded to several nonprofit organizations, the U.S. Forest Service, and state agencies. The sponsoring organizations and agencies pay participants to work in part-time community service jobs for about 20 to 25 hours per week, up to a maximum of 1,300 hours per year. The Department of Labor estimates that almost 100,000 such jobs will be created under SCSEP in program year 1995.

SCSEP participants work in schools, hospitals, and senior citizen centers and on beautification and conservation projects. They are paid the higher of the federal or state minimum wage or the local prevailing rate of pay for similar employment. Participants also receive annual physical examinations, personal and job-related counseling, and assistance to move into private-sector jobs when they complete their projects. SCSEP is not considered a training program, but in recent years it has put increasing emphasis on preparing its participants for unsubsidized employment. About 20 percent of enrollees move on to such jobs.

Eliminating SCSEP would reduce outlays over the 1996-2000 period by about $1.7 billion measured from the 1995 funding level and by about $1.8 billion measured from the 1995 level adjusted for inflation. Opponents of the program maintain that it offers few benefits aside from income support, and that the presumed value of the work experience gained by SCSEP participants would generally be greater if the experience were provided to equally disadvantaged young people, who have longer careers over which to benefit. In addition, the costs of producing the services now provided by SCSEP participants could be borne by the organizations that benefit from their work; under current law, those organizations bear only 10 percent of such costs. This shift would ensure that only those services that were most highly valued would be provided.

SCSEP, however, is the major federal jobs program aimed at low-income older workers, and eliminating it could cause hardship for older workers who are unable to find comparable unsubsidized jobs. In general, older workers are less likely than younger workers to be unemployed, but those who are take longer to find work. Moreover, without SCSEP, community services might be reduced if nonprofit organizations and states were unwilling or unable to increase expenditures to offset the loss of federal funds.

DOM-45 CONSOLIDATE SOCIAL SERVICE PROGRAMS AND REDUCE THEIR BUDGETS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Discretionary Spending						
From the 1995 Funding Level						
Budget Authority	a	595	595	595	595	2,380
Outlays	a	375	595	595	595	2,160
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	a	755	850	940	1,035	3,580
Outlays	a	480	815	905	1,000	3,200
Direct Spending						
Budget Authority	a	835	835	840	845	3,355
Outlays	a	785	835	840	840	3,300

a. The option would not take effect until 1997.

Social services are provided to many individuals and families through an array of programs, each with its own rules and regulations. Those programs may be administered at either the federal or state level by separate agencies, even though they serve the same or a very similar clientele. In recent years, the number of separate programs has grown, particularly in child care, which has seen five new ones enacted since 1988.

This option would consolidate a number of social service programs into one or more block grants. A large array of programs could be consolidated. For the purposes of this illustrative estimate, the consolidation would bring together the Social Services Block Grant (SSBG), the Community Services Block Grant, Title IV-A "At-Risk" Child Care and Transitional Child Care programs, the Child Care and Development Block Grant, Dependent Care Planning and Development Grants, and grants to states for services and meals from the Administration on Aging. Two block grants--one for families with young children and one for the elderly--might be appropriate since the programs being considered in this option provide services primarily to those groups.

Consolidating these programs and holding spending in their new budget at 25 percent below the 1995 funding level would reduce federal government outlays over the 1997-2000 period by $5.5 billion ($2.2 billion in discretionary spending and $3.3 billion in direct spending) measured from the 1995 funding level. The savings from the 1995 funding level adjusted for inflation would be $6.5 billion ($3.2 billion in discretionary spending and $3.3 billion in direct spending) over the same period. (The specific year-to-year savings would, however, depend on the particular features of the new block grant.) Three of the programs that would be consolidated--SSBG and the two Title IV-A child care programs--are entitlements that would affect direct spending. The remaining programs are discretionary and require annual appropriations. To allow time for designing and coordinating consolidation options, particularly the exact set of programs to include, implementation would be delayed until 1997.

With consolidation, localities could provide social services more efficiently. Duplicate services could be eliminated, and administrative costs would decline because of simpler rules and regulations that

would facilitate a reduction in administrative personnel. States and localities would have more freedom to tailor programs to local needs. Moreover, different services provided to the same individual or family could be coordinated more easily, improving service delivery from the client's perspective.

There would, however, be some risks. States would be unlikely to replace all or most of the lost federal funding, although individuals and families who were most in need could be protected, either by directing the consolidated grants toward states and areas with the lowest incomes or fiscal capacities or by federally mandating income limits for eligibility. In addition, because much of the affected spending is for child care subsidies, low-income mothers might find it more difficult to work outside the home, which could increase spending for welfare programs. Also, Transitional Child Care is an open-ended entitlement program, and converting it to a capped grant might reduce future funding. Finally, consolidation would diminish federal control over the specific uses of funds.

DOM-46 ELIMINATE OR REDUCE FUNDING FOR THE ARTS AND HUMANITIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Eliminate Funding						
From the 1995 Funding Level						
Budget Authority	1,114	1,117	1,117	1,117	1,117	5,582
Outlays	803	1,037	1,091	1,117	1,117	5,165
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	1,145	1,179	1,223	1,268	1,315	6,130
Outlays	823	1,085	1,181	1,251	1,297	5,637
Reduce Funding by 50 Percent						
From the 1995 Funding Level						
Budget Authority	557	559	559	559	559	2,793
Outlays	402	519	545	559	559	2,584
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	573	590	611	634	657	3,065
Outlays	412	543	590	626	649	2,820

NOTE: The savings shown in 1996 and 1997 would require a rescission of all or part of the advance appropriations for the Corporation for Public Broadcasting of $312 million in 1996 and $315 million in 1997.

The federal government subsidizes various arts and humanities activities. In 1994, federal outlays for the Corporation for Public Broadcasting, the Smithsonian Institution, the National Gallery of Art, the National Endowment for the Arts, the National Endowment for the Humanities, and the John F. Kennedy Center for the Performing Arts totaled about $1 billion.

Eliminating funding for these programs over the 1996-2000 period would reduce federal outlays by about $5.2 billion measured from the 1995 funding level and about $5.6 billion measured from the 1995 level adjusted for inflation. Holding funding at half of the 1995 level would save almost $2.6 billion measured from the 1995 funding level and about $2.8 billion measured from the 1995 level adjusted for inflation during that period. This option would reduce the appropriation by nearly 60 percent, in real terms, in the fifth year. The final effect of either option on arts and humanities activities would depend on the extent to which other funding sources--states, private individuals, firms, and foundations--increased their contributions and on whether higher admission fees to these activities were used to make up for reduced federal funding.

Proponents of this option argue that federal funding for the arts and humanities is not affordable in a time of fiscal stringency, especially when programs addressing central federal concerns are not fully funded. Moreover, because many arts and humanities programs benefit predominantly higher-income people, instituting or raising admission fees or ticket

prices could substitute for federal aid in many cases. In a number of cities here and abroad, for example, museums charge fees.

Reducing or eliminating federal appropriations for the arts and humanities would probably result in fewer of those activities, however, because other funding sources would not be likely to offset fully the loss in federal subsidies. As a result, activities that preserve and advance the nation's cultural heritage would be likely to decline.

DOM-47 REDUCE THE MATERNAL AND CHILD HEALTH CARE BLOCK GRANT AND THE PREVENTIVE HEALTH SERVICES BLOCK GRANT

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	421	421	421	421	421	2,105
Outlays	193	363	415	421	421	1,812
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	449	480	512	544	579	2,565
Outlays	206	401	484	522	555	2,168

In its appropriations for 1995, the Congress provided about $842 million in block grants for programs in maternal and child health and preventive health services. Almost all of those funds are distributed to the states, with a small amount being used for federal initiatives. The block grants, which are funded through the Public Health Service, allow states considerable flexibility in choosing the programs to fund within the specified areas. These grants do not generally restrict benefits to categories of recipients, such as low-income families.

Each block grant supports a wide range of programs. The Maternal and Child Health Care Block Grant subsidizes programs that provide such services as preventive care, prenatal care, health assessments for children, rehabilitation services for blind and disabled children, and community-based services for children with special health care needs. The 1995 funding for that block grant was $684 million. The Preventive Health Services Block Grant supports programs in such areas as immunization, hypertension control, dental health, environmental health, and injury protection. Funding for 1995 was $158 million.

If funding for each of these block grants was held at half of the 1995 funding level, the savings in outlays for the 1996-2000 period would be about $1.8 billion measured from the 1995 funding level and about $2.2 billion measured from the 1995 level adjusted for inflation. In 2000, spending would equal 43 percent of the 1995 spending level adjusted for inflation.

The principal justification for these reductions is that the federal commitment to other programs directed toward maternal and child health and preventive health services has increased substantially in recent years. For example, Medicaid's coverage of low-income women and young children has expanded in several ways. States are now required to provide Medicaid coverage to pregnant women and to children under age six in families with income below 133 percent of the federal poverty level. States are also now required to provide Medicaid coverage to children under the age of 19 who were born after September 30, 1983, and whose family income is below the poverty line. The phase-in will continue until all children under the age of 19 with family income below the poverty line are covered by Medicaid in 2002. Thus, the block grants are not essential for ensuring access to health services for those individuals.

In addition, states have the option of providing Medicaid coverage for pregnant women and infants in families with income of up to 185 percent of the poverty line. As of July 1994, 34 states and the District of Columbia had set income thresholds above 133 percent of the poverty line for that population. Similarly, between 1991 and 1994, funding for pro-

grams of the Centers for Disease Control and Prevention for immunization, tuberculosis control, prevention of human immunodeficiency virus infection, and breast cancer screening increased by $508 million.

The major disadvantage of cutting the block grants is that in the current fiscal environment, many states might be unable to assume a greater share of the financial responsibility for the affected programs. Cuts in the block grants could adversely affect the health of people--especially those in low-income families not eligible for Medicaid--who would receive less assistance from those programs.

DOM-48 ELIMINATE SUBSIDIES FOR HEALTH PROFESSIONS EDUCATION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	288	288	288	288	288	1,440
Outlays	138	256	288	288	288	1,259
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	298	308	319	330	342	1,596
Outlays	143	270	312	323	334	1,382

The Congress provided $288 million to the Public Health Service in 1995 to subsidize education for physicians, nurses, and public health professionals. Those funds primarily furnish institutional support through grants and contracts to schools for designated training programs in the health professions. A limited amount of the assistance is provided through loans, loan guarantees, and scholarships for students. The programs promote physician training in primary care, advanced nursing education, and increased enrollment of minority and economically disadvantaged students:

o *Primary care training.* Several programs provide federal grants to medical schools and teaching hospitals to develop, expand, or improve graduate medical education in primary care specialties and to encourage practice in rural and low-income urban areas. Funding for 1995 is $131 million.

o *Nursing education.* The subsidies to nursing schools are meant to increase graduate training for nurse administrators, educators, supervisors, researchers, and nursing specialists, including nurse-midwives and nurse-practitioners. Funding for 1995 is $61 million.

o *Support for minority and economically disadvantaged students.* Over half of these funds go to professional schools for recruiting, training, and counseling minority and economically disadvantaged students. The remaining funds are for student loans and scholarships. Funding for 1995 is $95 million.

Eliminating all of these subsidies would save, over the 1996-2000 period, about $1.3 billion measured from the 1995 funding level and about $1.4 billion measured from the 1995 level adjusted for inflation. The principal justification for this option is that market forces provide strong incentives for individuals to seek training and jobs in the health professions. Over the past several decades, physicians--the principal health profession targeted by the subsidies--have rapidly increased in number, from 142 physicians in all fields for every 100,000 people in 1950, to 161 in 1970 and 244 in 1990. Projections by the American Medical Association indicate that the total number of physicians per capita will continue to rise through 2000. In the case of nurses, if a shortage indeed existed, higher wages and better working conditions would attract more people to the profession and more trained nurses to nursing jobs, and would encourage more of them to seek advanced training.

Moreover, because the subsidies go mainly to institutions, they may have little effect on the numbers or characteristics of people studying to be health professionals. For example, most of the subsidies for nurses' training are directed toward increasing skills through baccalaureate degree programs and advanced

education in nursing, rather than raising the number of new entrants into the profession. Similarly, over half of the funds for increasing enrollment of minority and economically disadvantaged students are used to support schools' recruitment, training, and counseling efforts. Many critics of the subsidies contend that schools in the health professions have a strong commitment to recruiting students from diverse backgrounds. Given that commitment, schools would probably continue much of their recruiting and training efforts even if the subsidies were eliminated.

The major disadvantage of eliminating the subsidies is that the incentives supplied by market forces may not be sufficient to meet entirely the goals of these health professions programs. For example, third-party reimbursement schedules for primary care may not encourage enough physicians to enter those specialties and may not include financial inducements sufficient to increase access to care in rural and inner-city areas. In addition, fewer people might choose advanced training in nursing, which could limit the opportunities for the use of relatively inexpensive physician substitutes. Another drawback relates to the goal of increasing enrollment of minority and economically disadvantaged students. To the extent that schools did not fully offset the cut in federal funds for scholarships, fewer such students might enter the health professions, possibly exacerbating the problem of access to care in medically underserved areas.

DOM-49 REDUCE FUNDING FOR RESEARCH SUPPORTED BY THE NATIONAL INSTITUTES OF HEALTH

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	1,133	1,133	1,133	1,133	1,133	5,665
Outlays	487	1,043	1,133	1,133	1,133	4,929
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	1,507	1,905	2,329	2,755	3,209	11,705
Outlays	648	1,558	2,056	2,478	2,916	9,656

The federal government is providing $11.3 billion in 1995 for research funded through the National Institutes of Health (NIH). About 60 percent of the NIH research budget is awarded to universities and other nonprofit institutions through research grants and contracts. The rest is spent for research within the institutes, research contracts with industrial firms, research by state and local governments, foreign research, and administration.

A reduction in funding for NIH research could be justified by its rapid growth in recent years. Between 1984 and 1994, NIH expenditures more than doubled. If funds for NIH research were reduced to 90 percent of the 1995 funding level and held there, the 1996-2000 savings in outlays would be $4.9 billion. Measured against the 1995 funding level adjusted for inflation, the savings would be about $9.7 billion. The NIH could respond to such reductions by limiting its overhead reimbursements for research grants and by funding research projects at a reduced proportion of their costs, thereby encouraging researchers to find additional sources of support. (See DOM-63 for a related option.)

In 1995, NIH allocated $6.2 billion--over half of its total funding--to competitively awarded research grants. Reducing NIH funding might mean that fewer research grants could be awarded. Because funding for those projects is based on a rating system, the least promising projects would be dropped first. In 1992, NIH funded 30 percent of the grant applications it received. Reducing the number of grants that NIH awards could cause some biomedical researchers to leave the field or seek employment in the private sector.

The federal government is the mainstay of support for basic biomedical research on which advances in medical technology depend, and many people argue that the government should spend more, not less, on such research. Basic research is aimed at discovering fundamental properties of nature--it can result in new knowledge that has applications for many treatments. But the results of basic research usually cannot be appropriated by a single firm; rather, they increase a knowledge base that many firms use in their search for cures to specific diseases. Because a firm cannot fully appropriate the benefits of this kind of research, it may spend less on it than is socially optimal. Hence, many people argue that there is an important role for government in funding basic biomedical research.

Advocates of such funding point to the benefits of past federal support of basic research, which has played a role in the recent explosion of knowledge about molecular biology and human genetics. Such knowledge could help in the search for new diagnostic tests and cures for serious health conditions that threaten the lives or well-being of millions of people --for example, birth defects, arthritis, diabetes, multi-

ple sclerosis, immune system diseases, heart disease, and cancer. The reduction in NIH expenditures set out in this option could slow progress in those important areas.

Proponents of a reduction in NIH spending for health research and development maintain that the effects of less government funding could be softened by increases in private-sector expenditures. To support their claim, they point to the recent increase in such funding: between 1982 and 1992, private-sector spending for health research and development more than doubled, even exceeding the increase in NIH spending.

DOM-50 LIMIT THE GOVERNMENT'S SHARE OF THE COST FOR THE FEHB PROGRAM TO A FIXED AMOUNT PER EMPLOYEE

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Discretionary Spending						
Budget Authority	100	200	400	700	900	2,300
Outlay	100	200	400	700	900	2,300
Direct Spending						
Budget Authority	100	200	400	600	900	2,200
Outlays	100	200	400	600	900	2,200

NOTES: Estimates do not include any savings realized by the U.S. Postal Service.

In order to show the effect of the specific programmatic changes in this option, savings are calculated relative to spending that has been projected under the assumption that current laws and policies affecting this activity remain unchanged. Those current-law estimates differ from projections that are not based on any programmatic assumptions and simply assume that the 1995 level of spending for this acivity (or that amount adjusted for inflation) is provided in every year.

The Federal Employees Health Benefits (FEHB) program provides health insurance coverage for over 4 million active federal employees and annuitants, as well as their 4.6 million dependents and survivors, at an annual cost to the government of about $13 billion. Two important differences exist between the FEHB program and the health insurance coverage provided by private employers. First, participants in the FEHB program choose from among many health insurance plans offering varying levels of benefits and premiums; they can also switch plans during an annual open-enrollment period. In contrast, many private-sector employees are offered no choice among plans, although larger firms tend to provide several alternatives. Second, in the FEHB program, the government and participants jointly finance the coverage through insurance premiums. In 1995, the government is expected to pay, on average, about 72 percent of the premiums for active employees and 73 percent for annuitants. Many large private employers pick up the entire cost of covering an individual employee and roughly 75 percent of the additional cost of family coverage.

Although health insurance costs have risen sharply over the past decade, premiums for FEHB plans have, on average, risen more slowly than those for private-sector employers. Over the past five years, FEHB plan premiums have increased an average of 6.8 percent a year, whereas the premiums paid by medium and large firms surveyed by Hay/Huggins Company, a benefits consulting firm, increased by 10.8 percent a year. Furthermore, FEHB premiums are expected to decline by 3.3 percent in 1995; the Congressional Budget Office (CBO) projects, however, that aggregate private health premiums are likely to rise by about 5 percent. Much more so than private-sector employees, federal employees have been able to switch from high-cost to lower-cost plans to blunt the effects of rising premiums. The dollar cap in the cost-sharing structure of FEHB (see below) encourages that efficient behavior and intensifies competitive pressures on all participating plans to hold down premiums.

Here is how that cost sharing works. For both employees and retirees, the government contributes 75 percent of the premium for the particular option selected by the enrollee, up to a cap of $1,600 per year for individuals ($3,490 for families). The dollar cap is set at 60 percent of the average high-option premiums for individuals and families in the "Big

Six" plans--five large plans and a phantom plan that acts as a placeholder for a former participating insurer. (Employer costs are higher under the U.S. Postal Service collective bargaining agreement.) Employees have an incentive not to choose plans with premiums above $2,133 ($4,653 for family coverage) because they pay 100 percent of the added cost of the premium. Thus, the dollar cap helps to control program costs.

By contrast, the requirement that enrollees pay 25 percent of the premium in plans with costs below $2,133 gives employees only a weak incentive for price-conscious selection among those health plans and also blunts price competition among plans to attract participants. Under the current arrangement, if an employee switched from a plan costing $2,100 to one costing only $1,800, his or her annual cost would be reduced by only $75. The provision requiring employees to pay at least 25 percent of premiums potentially affects an increasing proportion of enrollees. Between 1987 and 1992, the number of enrollees paying 25 percent of the premium while the government contributes less than the maximum dollar amount rose from 28 percent of total enrollment to 69 percent.

Budgetary savings and better cost-reducing incentives would be gained by revising the FEHB program so that the government simply paid the first $1,535 of an employee's premium ($3,430 for family coverage). Those amounts are based on the average government contributions in 1995 and would increase annually by the rate of inflation rather than by the rate of change in the Big Six premiums. Because those premiums are expected to rise faster than inflation, the government's savings would be considerable. In addition, the government would have more control over its premium contributions because they would be more predictable. Federal employees and retirees would also have the opportunity--by choosing low-cost plans--to reduce their share of the total premium below the 25 percent minimum under current law.

Compared with current law, savings in discretionary spending from reduced payments for *current employees* and their dependents would total $2.3 billion over five years. Yet despite those savings, government spending for FEHB premiums for current employees would still be growing each year. If the goal was to hold government payments constant over time, additional policy actions would be required. Savings in direct spending, relative to current-law spending, from reduced benefits for *retirees* would reach $2.2 billion over five years. CBO's estimate does not include any savings from potential reductions in premiums as a result of increased competition among insurance plans.

This option would require the roughly two-thirds of all enrollees who currently choose a plan with a premium in the range of $1,535 ($3,430 for family coverage) to $2,133 ($4,653 for family coverage) to pay all of the premium above the new cap--not just one-quarter of it, as at present. The 31 percent of participants enrolled in the Blue Cross-Blue Shield high-option plan and other plans with premiums above $2,133 ($4,653) would also continue to pay all of that extra cost. With all consumers subject to paying all of those incremental costs, the incentive to select a lower-cost plan would be strengthened. Because purchasers would be more price-conscious, many plans would have a greater incentive to economize and offer lower premiums to retain their participants. Almost all plans currently have premiums above $1,535 ($3,430 for family coverage), and there would be no incentive to offer a premium below that amount. In the lowest-cost plans, which include the standard options under the Mail Handlers and the George Washington University Hospital plans, enrollees could look forward to having the government pay the entire premium, with no cost to them.

The health care sector is currently undergoing dramatic changes. After several years of extremely rapid growth, spending slowed in the early 1990s. Employers and employees, in sorting out some new health insurance options, have stirred up a nascent price competition among health plans--historically, a weak force. A variety of new plans, commonly grouped under the managed care category, are attempting to capitalize on the new price consciousness of consumers and are rapidly claiming a share of the market from traditional fee-for-service plans. In 1994, about 40 percent of federal employees were enrolled in managed care plans.

This proposal would accelerate the changes currently under way in the health care market by intensi-

fying competition among FEHB plans. The FEHB program is often held up as a model of managed competition. If that approach works as theorists have predicted, the program changes in this option could reduce the growth of health premium costs. Many FEHB plans, especially the managed care plans, have a significant ability to control their premium costs. Further, enrollees would receive the full benefit if their premiums rose more slowly than inflation.

On the downside, this option would result in enrollees' paying an increasing share of their premiums when premium rates rose faster than inflation. Currently, the government bears most of that risk; large private-sector employers bear essentially all of it. The added cost to workers would amount to about $500 per worker in 2000 and more in later years. Asking employees and retirees to pay more would have a number of consequences. Although it could encourage participants to select more cost-efficient plans, it could also place more participants in plans with inferior benefits. Because the added costs to employees amount to a reduction in compensation, the government might find it harder to attract and retain high-quality employees. Finally, for current retirees and long-time federal workers, cuts in promised benefits amount to a retroactive change in the terms of their employment that lowers their standard of living. (For further discussion of the pros and cons of such cuts, see DOM-60 and ENT-50.)

The option has an additional drawback in that it would strengthen the existing incentives for FEHB plans to seek out healthy people and for healthy people to select cheap plans. Those patterns isolate sick people in selected plans that then experience increases in costs and risk financial instability. The Office of Personnel Management, which administers the FEHB program, can review plans to try to limit that form of adverse selection. However, its effectiveness in limiting all adverse selection is doubtful.

DOM-51 REDUCE FEDERAL RENT SUBSIDIES BY SHIFTING SOME COSTS TO TENANTS OR THE STATES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Reduce Section 8 Subsidies						
Budget Authority	140	306	724	820	1,344	3,334
Outlays	218	454	708	983	1,281	3,644
Reduce Public Housing Operating Subsidies						
Budget Authority	108	222	346	478	620	1,774
Outlays	49	158	277	404	541	1,429

NOTE: Savings from the 1995 funding level and from the 1995 funding level adjusted for inflation would be essentially equal because they would depend on tenants' incomes and on the number of assisted households, both of which would be virtually the same for the two funding levels.

Most lower-income renters who receive federal rental assistance are aided through the Section 8 programs or the public housing program, which are administered by the Department of Housing and Urban Development (HUD). Those federal programs usually pay the difference between 30 percent of a household's adjusted income and either the actual cost of the dwelling or, under the Section 8 voucher program, a payment standard. In 1994, average federal expenditures per assisted household for all of HUD's rental housing programs combined were roughly $4,800. That amount includes both housing subsidies and fees paid to administering agencies.

Savings in outlays could be achieved by reducing federal payments on behalf of recipients. To diminish or eliminate the impact of that change on assisted tenants, state governments--which currently contribute no funds toward these federal rental assistance programs--could be allowed to make up some or all of the decrease. This option would increase combined tenant and state rent contributions over a five-year period from 30 percent to 35 percent of a tenant's adjusted income. For the Section 8 programs, it would save a total of $3.6 billion in outlays over the 1996-2000 period. For public housing, total savings would be $1.4 billion over the five-year period. (The savings from the 1995 funding level and from the 1995 funding level adjusted for inflation would be essentially equal over that period. That outcome occurs because savings would depend on tenants' incomes and on the number of assisted households, both of which would be virtually the same for the two funding levels.) Realizing those savings, however, would require changing the authorizing legislation for those programs as well as cutting annual appropriations.

One rationale for involving states in housing assistance is that those programs generate substantial local benefits, such as improved quality of the housing stock. If all states paid 5 percent of the adjusted incomes of those receiving assistance, housing costs for assisted families would not rise. Moreover, since eligibility for housing assistance is determined by each area's median income, tying states' contributions to renters' incomes would ensure that lower-income states would pay less per assisted family than would higher-income states. Finally, if a state chose not to participate and consequently rent payments by its households increased to 35 percent of their adjusted incomes, those out-of-pocket costs would still be well below the nearly 50 percent of income that the typical unassisted renter who is eligible for assistance pays.

Absorbing part of the costs of rental housing assistance, however, would be difficult for states that are experiencing fiscal distress. Unless all states made up the reduction in federal assistance, this strat-

egy would increase housing costs for some current recipients of aid, who are generally poor. Moreover, raising rent payments could prompt some stable, slightly higher-income households to leave assisted housing projects in areas of the country where unassisted housing of the same quality would now be cheaper. That outcome would change the economic mix of households in those projects, possibly reduce the projects' viability, and increase the average cost of subsidizing them.

DOM-52 STOP EXPANSION OF THE NUMBER OF RENTAL ASSISTANCE COMMITMENTS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	4,680	4,901	4,962	4,985	4,985	24,513
Outlays	11	485	1,154	1,969	3,008	6,627
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	4,845	5,252	5,510	5,729	5,946	27,282
Outlays	16	506	1,216	2,103	3,256	7,097

Each year since 1975, the Department of Housing and Urban Development (HUD) has made new commitments under the Section 8 and public housing programs. Those new commitments, which today cover periods ranging from five to 20 years, provide rental housing assistance for additional lower-income households, thereby increasing the total number receiving aid. At the end of 1994, about 4.7 million commitments for rental assistance were outstanding for all housing programs combined.

Outlays for all rental assistance programs combined totaled more than $22 billion in 1994. If those programs were funded for 1996 and thereafter at the 1995 funding level, total outlays would increase to around $31 billion by 2000. (That estimate is based on the assumption that the Congress would provide budget authority to extend the life of all commitments that will expire over the 1996-2000 period. The Omnibus Budget Reconciliation Act of 1990 directs CBO to incorporate the cost of future renewals into its budget projections for housing aid.)

Even if no budget authority was appropriated for 1996 and later years for commitments to assist additional households, outlays would rise to around $28 billion by 2000. (That increase would take place because some outstanding commitments have not yet resulted in actual assistance; because subsidies per household increase annually as a result of inflation; and because expenditures would continue for other purposes such as providing incentives to owners of certain housing projects to preserve them for low-income use.) Nevertheless, compared with the 1995 funding level, this option would reduce outlays by about $3 billion in 2000 and by about $6.6 billion over the 1996-2000 period. Savings from the 1995 funding level adjusted for inflation would amount to $7.1 billion over the period. Additional savings would accrue under this option after 2000, when the unappropriated budget authority would otherwise have been spent.

An argument in favor of this option is that expanding rental assistance programs is inappropriate in light of present cutbacks in other areas. Furthermore, existing commitments would continue to assist many new income-eligible households each year because of turnover among assisted renters. Finally, no current recipients would lose their housing assistance as a result of this option.

An argument against the option is that the upward trend in the proportion of eligible renters actually receiving assistance has almost leveled off at about 30 percent because the number of new commitments funded annually dropped significantly during the 1980s. If the number of commitments was frozen, the proportion of eligible renters receiving assistance would fall because of continued growth in the number of eligible households. As a result, the number of eligible households with one or more housing problems--such as paying a relatively large share of income for rent or living in a physically inadequate or crowded dwelling--would probably increase.

DOM-53 SHIFT RENTAL HOUSING ASSISTANCE FROM NEW CONSTRUCTION TO VOUCHERS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Sections 202 and 811						
Budget Authority	1,192	1,192	1,192	1,192	1,192	5,962
Outlays	-3	-38	-8	108	400	459
Public Housing[a]						
Budget Authority	522	522	522	522	522	2,609
Outlays	-2	-16	74	179	310	544
From the 1995 Funding Level Adjusted for Inflation						
Sections 202 and 811						
Budget Authority	1,232	1,274	1,319	1,364	1,412	6,600
Outlays	-3	-40	-10	110	415	472
Public Housing[a]						
Budget Authority	539	557	577	597	618	2,888
Outlays	-2	-17	75	187	329	572

a. CBO projections of the 1995 funding level and the 1995 funding level adjusted for inflation do not include budget authority to cover any increases in operating subsidies associated with public housing units to be constructed in the future. Therefore, relative to those two projected funding levels, this option would not generate savings in such subsidies.

A number of federal programs administered by the Department of Housing and Urban Development (HUD) subsidize the housing costs of lower-income households. The programs provide rental assistance through two basic approaches: subsidies that are tied to projects specifically constructed for lower-income households and subsidies that enable renters to choose standard housing units from existing private housing. Since the early 1980s, construction of low-income housing has been sharply curtailed in favor of using less costly existing housing. The only construction programs under which new commitments are still being made are the Section 202 and Section 811 programs (for the elderly and disabled, respectively) and the public housing program. For 1995, about one-quarter of additional assistance commitments are for construction of new dwellings, and the remaining ones are provided through the Section 8 existing-housing certificate and voucher programs.

Appreciable savings in the costs of housing programs could be realized by substituting vouchers for new construction. Total savings over the long run are evident when the cost of using vouchers is compared with the cost of new construction in terms of their present values, but not necessarily evident when they are compared in terms of year-by-year outlays as reflected in the budget. (Present value indicates the amount of money that would have to be put in the bank today in order to cover a future stream of costs.) This apparent contradiction occurs because of differences in the patterns of outlays for the two approaches. Construction programs require large up-front federal outlays for building the projects, with relatively low annual outlays for operating subsidies thereafter. In contrast, annual outlays for vouchers are more constant over time but exceed those for annual operating subsidies.

The options shown here would eliminate new commitments for construction and replace them with vouchers on a one-for-one basis. The savings shown in the table are not measured in terms of present values, however, because of budgetary conventions. Nevertheless, the budget would show net savings in outlays over the 1996-2000 period. In particular, compared with the 1995 funding level, outlays would decrease by $459 million for the Section 202 and Section 811 programs and by $544 million for the public housing program. Net savings from the 1995 funding level adjusted for inflation would amount to $472 million for the Section 202 and Section 811 programs and $572 million for the public housing program. Those savings reflect the elimination of up-front construction expenses. Savings in outlays would continue to occur for some time after 2000, but eventually the budget would reflect the higher annual outlays of vouchers compared with operating subsidies.

Substantially greater savings in budget authority would occur over the five-year period, but again, those short-term savings do not represent the complete picture. For example, in the Section 202 and Section 811 programs, the savings would derive partially from the shorter contract term of vouchers (five years) compared with rental assistance in the newly constructed projects (20 years). Consequently, they would be offset by higher budget authority after 2000, if expiring vouchers were renewed for 15 more years. (In the calculations of present values, on which the earlier discussion was based, that difficulty was avoided by using the same period of time for both types of aid.)

Proponents of these options see little need for subsidizing new construction. The overwhelming housing problem today, they argue, is not a shortage of rental units but the inability of poor households to afford existing units. For example, nationwide average annual vacancy rates have consistently exceeded 7 percent since 1986, the highest levels since 1968. Furthermore, even if there are shortages, subsidizing new construction may merely displace private activity rather than add to the total housing stock. Also, the construction of subsidized housing is generally a slow process that, at best, has an impact only after a long lag. Vouchers could help low-income households more quickly and at a lower cost to the federal government than would new construction. In addition, vouchers would give low-income households greater flexibility in choosing where to live.

National statistics on the supply of rental units, however, may mask local shortages of certain types of units that rent within HUD's guidelines for vouchers. Many elderly and disabled households, in particular, need housing that can provide special social and physical services that are not available in their current residence. Supporters of subsidized construction of units for elderly and disabled households contend that the private sector does not respond adequately to those demands because it produces units that people with low income typically cannot afford, even when vouchers subsidize rents. Similarly, a relatively large proportion of lower-income families with children live in crowded conditions. Many of them need units with three or more bedrooms. A number of the nation's large public housing authorities report that their jurisdictions have shortages of those large units with rents within the HUD guidelines.

DOM-54 ELIMINATE OR SCALE BACK LOW-INCOME HOME ENERGY ASSISTANCE

	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
			Eliminate Program			
From the 1995 Funding Level						
Budget Authority	1,919	1,919	1,919	1,919	1,919	9,595
Outlays	1,351	1,469	1,469	1,469	1,469	7,227
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	1,939	2,005	2,076	2,147	2,222	10,389
Outlays	1,354	1,520	1,574	1,628	1,685	7,761
			Scale Back Program			
From the 1995 Funding Level						
Budget Authority	960	960	960	960	960	4,800
Outlays	675	735	735	735	735	3,615
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	979	1,045	1,116	1,188	1,263	5,591
Outlays	679	785	839	894	950	4,147

NOTE: The CBO baseline includes $3.3 billion during the 1996-2000 period that is contingent on the President's designation of an emergency. In addition, the savings shown for 1996 would require a rescission of part or all of the $1.3 billion advance appropriation in the 1995 appropriation act.

The Low Income Home Energy Assistance Program (LIHEAP) helps pay the home energy costs of some low-income households. Authorized by the Omnibus Budget Reconciliation Act of 1981 and administered by the Department of Health and Human Services, LIHEAP funding for block grants to states was $1.9 billion in 1995. States may use the grants to help eligible households pay their home heating or cooling bills, meet energy-related emergencies, or fund low-cost weatherization projects.

Households may be eligible if they receive assistance from certain other programs, such as Aid to Families with Dependent Children or Supplemental Security Income, or if their income is low. In addition, federal law requires that states give preference to households with the highest energy costs (relative to income) when disbursing LIHEAP funds. Only about one-third of eligible households actually receive assistance.

Eliminating LIHEAP would save $7.2 billion in federal outlays during the 1996-2000 period measured from the 1995 funding level and $7.8 billion measured from the 1995 level adjusted for inflation. Holding future appropriations at 50 percent of the 1995 funding level would reduce outlays by about half those amounts.

LIHEAP was created in response to the rapid increases in the price of energy used in the home in the late 1970s and early 1980s. Since the program's enactment in 1981, real prices of household fuels have declined by 22 percent, although they remain somewhat above their early-1970s levels. Those lower real prices might now warrant either eliminating or

reducing LIHEAP. Moreover, 26 states transferred up to 10 percent of their LIHEAP funds during 1993 to supplement spending for five other social and community services block grant programs; the transfers indicate that some states believe that spending for energy assistance does not have as high a priority as other spending. (That authority to transfer funds is no longer available.)

The most recent LIHEAP appropriation, however, is 38 percent below the program's original 1981 level of funding in real terms, a larger decline than the drop in real prices of household fuels. Moreover, the appropriation includes $600 million that cannot be spent unless the President designates an emergency. Additional reductions would create hardships for some low-income households, forcing them to choose between paying for energy or for other household necessities. A further argument for retaining LIHEAP at some level is the flexibility it provides to respond quickly to a future spurt in energy prices.

DOM-55 CLOSE OR CONVERT INEFFICIENT OR UNDERUSED FACILITIES IN VETERANS' HOSPITALS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	85	170	255	340	340	1,190
Outlays	73	158	243	328	340	1,142
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	87	180	277	380	390	1,314
Outlays	75	167	263	365	389	1,259

The Department of Veterans Affairs (VA) operates a nationwide medical care system that in 1994 included 172 hospitals with 54,000 inpatient beds, 130 nursing homes, and 365 outpatient clinics. Most of the hospitals are large, modern, and well staffed, providing access to high-quality care for eligible veterans. Although many of the hospitals are treating increasing numbers of patients, other facilities have experienced a declining demand for services, such as major surgery or common acute care procedures. In response, the VA in 1994 opened additional nursing home beds that had been converted from hospital beds.

The VA could achieve greater efficiency by closing small hospitals or underused units within hospitals or by converting them into facilities that offered services in greater demand. The criteria for closure could include the existence of adequate alternative sources of care, as well as low numbers of veterans using the VA facilities. Carrying out this option would require changing both the program's authorization and its appropriation.

The level of savings that could be achieved would depend on several factors: whether complete hospitals or merely wings within hospitals were closed or converted; whether conversions substituted for new construction that would otherwise have occurred; and the extent to which gross savings from closure or conversion would be absorbed by increased costs for transportation or private care incurred for some veterans under the restructured arrangements. If overall savings were equal to those from the gradual closing of 4 percent of VA hospital beds, federal savings from 1996 through 2000 would total about $1.1 billion measured from the 1995 funding level and about $1.3 billion measured from the 1995 level adjusted for inflation.

This option would reduce the number of expensive surgical and other acute care medical facilities with low rates of use or occupancy. Closing or converting those facilities would not eliminate VA care for veterans--patients would be transferred to other VA hospitals or appropriate private facilities--but needed care would be provided more economically. To the extent that veterans were transferred to facilities that had greater professional resources or that undertook relevant surgical procedures more frequently, closure or conversion would also improve the quality of the care that veterans received.

This option could have the effect, however, of reducing access to health services for some veterans who receive care on a space-available basis within underused VA facilities. Some veterans might also find care more difficult to obtain if closures in rural areas without other facilities required them to travel greater distances to receive care.

DOM-56 REVISE THE MANDATORY SENTENCING SYSTEM FOR SOME NONVIOLENT FEDERAL CRIMES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	0	0	4	9	16	29
Outlays	0	0	4	8	15	27
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	0	0	4	10	18	32
Outlays	0	0	4	9	17	30

For people convicted of certain crimes, federal law requires judges to impose mandatory minimum prison sentences. Defendants are not eligible to receive parole, probation, suspended sentences, or other alternative punishments. Deviations from that standard may occur only in cases in which prosecutors file a "substantial-assistance" motion on behalf of a defendant and a departure is granted by the presiding judge.

The enactment by the Congress of the Sentencing Reform Act of 1984 and other statutes covering drug and firearm violations dramatically increased the number of crimes carrying mandatory minimum sentences and the number of prisoners under the jurisdiction of the federal prison system. Support for minimum sentences derives from several sources: public demands to "get tough" on crime, a drop in public confidence regarding the efforts of prisons to rehabilitate criminals, well-publicized horror stories of recidivist crimes, and the desire of lawmakers to eliminate sentencing disparities.

Many people who are convicted of crimes under statutes requiring mandatory sentences are nonviolent offenders--specifically, nonviolent drug offenders--with little or no criminal history, as classified by the Bureau of Prisons. For example, an analysis of federal prison statistics for 1991 determined that 87 percent of drug offense defendants with zero or one criminal history point (no more than one prior sentence of less than 60 days including probation or a fine) received prison sentences. Furthermore, the Department of Justice reported in February 1994 that more than 20 percent of federal prisoners in June 1993 were "low-level" drug offenders with no record of violence.

Mandatory incarceration of those offenders is costly and uses prison space that could be assigned to violent and more dangerous criminals. Nonviolent drug offenders could be punished for shorter durations or by more cost-effective means. Alternative punishments include fines or restitution, probation, community service, electronic home monitoring, shock incarceration ("boot camps"), or supervised release. However, the use of those alternatives is currently limited by the U.S. Code, the sentencing guidelines, and bureau regulations. Eliminating or reforming the mandatory minimum sentencing system for nonviolent offenders could reduce federal outlays by $27 million over five years measured against the 1995 funding level and by $30 million over five years measured against the 1995 level adjusted for inflation. More significant savings would accrue in the future as the prison population fully adjusted to the reforms. Ten years hence, annual savings would be between $40 million and $50 million at current prices.

Budgetary savings under this option are uncertain. They depend on whether freed-up space is

filled with violent criminals who would remain incarcerated for longer periods and on the effects of reform on expansion of federal prison capacity.

For the purposes of these estimates, CBO assumed that the mandatory minimum sentences for nonviolent offenders would be reduced by approximately 50 percent, the annual cost of incarcerating an inmate would be about $20,000, and 500 to 700 prisoners would be eligible for the sentence reduction each year. The estimates also assume that appropriations would be reduced accordingly and no substitutions--of prisoners with reduced sentences for other types of offenders--would occur.

Proponents of reforming the mandatory minimum sentencing system argue that it has not achieved its primary goals. They contend that mandatory minimums, particularly in the case of nonviolent offenders, have moved prisons away from their primary mission--the removal of violent criminals from society--and, in fact, have led to reduced punishments for such criminals because of overcrowding. Furthermore, contrary to what was intended, mandatory minimums have not eliminated unwarranted disparities in sentencing; rather, they have created unwarranted sentencing uniformity by transferring discretionary authority from judges, who are limited in their sentencing options, to prosecutors, who determine which offenders may plea-bargain and potentially receive reduced sentences. In addition, because mandatory minimums increase the likelihood of long prison terms, many defendants believe they have nothing to lose and are more willing to risk going to trial. Consequently, significant backlogs have been created in the courts, and prisons have been populated beyond their intended capacity.

Perhaps most important, argue supporters of reform, are the differences in the fundamental nature of nonviolent drug crimes and violent crimes such as rape or murder. Most adult nonviolent drug crime is consensual; that is, it occurs between parties that engage in such conduct voluntarily. Moreover, since a large portion of drug crime is driven by the opportunity for huge profits, the mandatory incarceration of drug offenders overwhelms current prison capacity but does not change those financial incentives. Removing one drug offender from society just opens the door for others. Conversely, jailing pathological criminals such as child molesters or murderers has a tangible impact on the crime rate: it removes the cause of crime from the streets.

Proponents of reform also contend that alternative punishments or shorter sentences for nonviolent offenders could be equally effective and less costly than prison confinement. Fines and restitution in addition to probation, for example, may be appropriate penalties for some defendants and could allow offenders to compensate any victims of their transgressions. Such penalties may also allow nonviolent offenders to remain in the community as taxpayers and pay the fines or costs associated with their sentences more easily. Electronic home confinement might be another workable alternative to federal prison: it would restrict the movement and actions of some offenders while imposing significantly smaller costs than full-time prison confinement. Finally, shock incarceration, or boot camp, and its highly regimented prison term may be more constructive than traditional incarceration for some younger offenders.

Critics of this option maintain that mandatory minimum sentences are justified because they fulfill important law enforcement and sentencing goals. Just as legislators constrain judges with punishment ceilings that prevent disproportionate punishments, mandatory minimum sentences create a floor for punishment that cannot easily be breached. Moreover, mandatory minimums complement the "no parole" conditions of federal law, thereby promoting "truth in sentencing." Such well-defined terms, opponents contend, best serve two of the most important goals of sentencing--the incapacitation and deterrence of criminals. And because of the substantial-assistance provisions, which give prosecutors the leeway to offer defendants reduced sentences in exchange for cooperation with law enforcement officials, mandatory minimums make it more likely that other criminals will be captured. Furthermore, many supporters of such sentences would argue that all drug crime, even at the lowest level, is an inherently violent act because it supports drug traffickers and kingpins who often resort to violence.

Those who oppose alternative punishments or changes in the mandatory minimum system emphasize the benefits of "certainty in punishment" that accompany punishment floors. Guaranteed prison

terms increase public safety by ensuring that no new criminal offenses will be committed by offenders for the duration of their sentence. Opponents of change also contend that unwarranted severity in punishments is a minor problem and that in only a very few cases (around 5 percent) does the mandatory minimum sentence exceed the punishment that would have been allotted under the guidelines sentencing system. Finally, offenders who fail to conform to the terms of alternative punishments may actually be sentenced to longer prison terms than if they had been incarcerated initially.

DOM-57 ELIMINATE CERTAIN CRIME PREVENTION PROGRAMS AUTHORIZED IN THE 1994 CRIME BILL

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	48	48	48	48	48	238
Outlays	9	33	47	48	48	184
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	49	51	53	54	56	263
Outlays	9	35	50	52	54	200

The Violent Crime Control and Law Enforcement Act of 1994 substantially increased funding for crime prevention programs. Twelve of those programs have been targeted for elimination in proposed amendments to the crime bill. The 12 programs are all authorized in title III of the act, which focuses on crime prevention, and most of them are to be funded from deposits in the Violent Crime Reduction Trust Fund. The programs are the Ounce of Prevention Council, the Local Crime Prevention Block Grant program, the Model Intensive Grants program, the Family and Community Schools Endeavor Grant program, Assistance for Delinquent and At-Risk Youth, Police Recruitment, the Local Partnership Act (funded from the Local Government Fiscal Assistance Trust Fund), the National Community Economic Partnership, Urban Recreation for At-Risk Youth, Community-Based Justice Grants for prosecutors, the Family Unity Demonstration project, and Gang Resistance Education and Training.

Measured from the 1995 funding level, savings from eliminating those 12 programs would total $9 million in 1996 and $184 million over the 1996-2000 period. Measured from the 1995 level adjusted for inflation, savings would total $9 million in 1996 and $200 million over five years. However, because only three of the 12 programs are authorized to begin in 1995, calculating savings from the 1995 funding level significantly understates the potential spending reductions. If one assumed that all 12 programs were fully funded at their authorized levels through 2000, eliminating them would mean a maximum cut of $3.9 billion over the 1996-2000 period. That action would result in estimated outlay savings of $3.3 billion over the five-year period.

In 1995 alone, the federal government will fund anticrime programs totaling at least $3.0 billion, with approximately $2.4 billion of that spending attributable to the new crime bill. A recent report by the General Accounting Office cataloged 266 federal crime prevention programs--for youth alone--already in operation before enactment of the crime bill and spread across many agencies of the federal government. Funding for such programs has been increasing steadily.

Critics of title III question whether a layer of new programs--entailing further increases in spending and, in some cases, alleged duplication of effort--is appropriate. They contend that the entire crime prevention effort is uncoordinated, inefficient, and even wasteful. Some argue that the federal government directs too much of its attention toward problems that are not federal responsibilities, noting that less than 5 percent of the laws on the books are federal laws. From that perspective, effective programs to prevent crime are necessarily local programs--tailored to individual communities and responsive to different social histories and attendant problems. Those critics object to expansions of what they term Great Society

social welfare programs and believe that more federal funding for crime prevention will lead only to more government control and regulation.

Finally, opponents of additional crime prevention funding assert that the most effective deterrent to crime is not what they term arts and crafts programs but strong, swift, certain punishment for crimes that have been committed. They espouse mandatory prison sentences, enhanced use of the death penalty, and measures to strengthen prosecutors.

Supporters of additional funding claim that the best way to deal with high levels of crime is not through retroactive punishment of offenders but by education, training, and recreation and employment opportunities provided through community-building organizations. They maintain that the crime prevention programs in the crime bill constitute an important balance compared with the much larger amounts of money provided for law enforcement activities. That balance, they argue, is similar to a responsible approach to health care, which would fund not only treatment of a disease but its prevention. They disagree with the notion that a person must be caught committing a crime before government has any responsibility to intervene.

Supporters of additional funding for crime prevention also argue that the "ounce of prevention" it provides is, in the long run, much less costly than a "pound of punishment," and that it deserves to be tried as part of any serious effort to reduce the costs to the nation of the burgeoning crime problem. They cite studies that show measurable drops in rates of crime--and therefore drops in the costs of courts and prisons--as a result of crime prevention programs.

Proponents also point to what they see as the vital role of the federal government in encouraging local efforts on behalf of a crime problem that is national in scope. Those advocates argue that the purpose of federal crime prevention assistance is to persuade states and localities to address problems that they otherwise might be forced to neglect because of scarce resources.

DOM-58 REDUCE FUNDING FOR LAW ENFORCEMENT EFFORTS TO CONTROL ILLEGAL DRUGS

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	1,824	1,824	1,824	1,824	1,824	9,120
Outlays	1,077	1,570	1,732	1,781	1,799	7,958
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	1,892	1,958	2,030	2,102	2,180	10,162
Outlays	1,118	1,667	1,896	2,016	2,108	8,804

The federal government currently allocates over $13 billion to the war on drugs. Of that amount, approximately $8 billion is directed toward controlling the supply and distribution of illegal drugs in this country. The remainder is allocated to research and development, treatment, education, and other efforts to control the demand for drugs. Interdiction and international activities account for $1.8 billion of the funds designated for efforts to control the supply of drugs.

The results of this formidable effort have been mixed, and both supporters and detractors of current law enforcement activities can find encouragement in recent trends. Some indicators show that drug use is significantly less prevalent than it was before the inception of the war on drugs, while other measures show that there has been no decline among certain important subgroups, especially hard-core users. With no clear proof of the efficacy of law enforcement efforts against drugs, some critics argue that the federal government could drastically reduce the resources directed toward the problem without affecting drug use over the long term.

This option recommends the elimination of drug interdiction and international activities to control the supply of drugs. Those two efforts are the ones for which critics find the most questionable results. The Congress has already moved to scale back funding for those activities, with the result that their appropriations for 1995 were more than $400 million lower than the 1993 funding level. Over five years, this option would save $8.0 billion measured from the 1995 funding level and $8.8 billion measured from the 1995 level adjusted for inflation.

This option would eliminate not only those drug supply activities conducted by nondefense agencies but those of the Department of Defense as well. Defense-related efforts account for about one-fourth of interdiction and international activities, and efforts related to the administration of justice account for about two-fifths. The remainder is split between the budget functions for transportation and international affairs. This option would leave unchanged the funding for treatment, education, and other activities focused on controlling the demand for drugs.

Proponents of reducing federal spending for interdiction and international activities argue that those efforts have not and cannot have a lasting effect on either the availability of or the demand for drugs. They have undoubtedly made it more difficult and more costly to grow, process, import, and distribute illegal drugs; but no hard evidence exists to support the hypothesis that intensified efforts have kept those drugs away from users or pushed prices up to levels that, in the long run, appreciably reduced the amount of drugs being purchased. In fact, some sources show that illicit drugs are less expensive and more readily available now than they were before the inception of the war on drugs.

In addition, current research shows that efforts to cut off the supply of drugs in their country of origin are not cost-effective, because producers' costs are only a small part of the users' charges. As drugs proceed farther along the processing and delivery chain, disruptions have a greater effect on retail prices and thus, one assumes, produce a greater deterrent effect. This evidence suggests that, to use law enforcement dollars to the greatest advantage, efforts should focus on the later stages of drug supply, particularly at the street level, where responsibility rests with state and local units of government. Of course, efforts to control the supply of drugs at that level are tenuous for several reasons: competition among producers and distributors, the large markup from wholesale to retail prices, and the ability of distributors to dilute the drug and so maintain an end price that customers can afford.

Proponents of cutbacks in law enforcement efforts also argue that factors related to demand, rather than supply, are dominant in determining drug use. In the past 10 years, most measures of substance abuse have shown significant declines, including lower levels of serious drug use and reductions in the number of people needing treatment. Although causality cannot be assigned, one could argue that the declines are independent of the level of federal resources allocated to controlling drug use. Proponents of reducing enforcement efforts claim that perceptions of health risks and societal attitudes, not enforcement, have probably reduced the demand for drugs among casual users. They also argue that stepped-up levels of enforcement could not have controlled past increases in the number of people with serious drug problems because hard-core users tend to become immune to such efforts. Instead of more enforcement, proponents argue for an expansion or reshaping of existing drug education and treatment programs and for more attention to societal problems, such as dysfunctional families, that contribute to overall drug use.

Those opposed to cutting funds for drug enforcement and related efforts point to the successful side of these activities: the destruction of major drug trafficking organizations and the large quantities of illegal crops and drugs that have been destroyed or seized. Law enforcement planners believe that they can take some credit for the reductions seen in drug use since its apex in the mid-1980s; they argue that street prices would have been much lower, and the availability of drugs much greater, without extensive funding for criminal justice efforts. Given that overall drug use remains at unacceptably high levels and that some indicators show recent increases in some categories of use, they contend that it would be premature and irresponsible to reduce or shift current resources away from enforcement. They point out, moreover, that criminal justice efforts are needed as much to keep some control over illegal drug activity as to reduce it, and that many programs are hard-pressed to maintain their existing levels of effort even with current funding. For some agencies, cutting back their funding for interdiction and international efforts would also disrupt some of their activities that are not related to combating the use of drugs.

DOM-59 REDUCE FUNDING FOR JUSTICE ASSISTANCE AND CERTAIN JUSTICE-RELATED ACTIVITIES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	492	492	492	492	492	2,460
Outlays	383	462	488	492	492	2,317
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	508	525	544	563	582	2,722
Outlays	396	490	534	577	557	2,554

In addition to the law enforcement activities that the Department of Justice (DoJ) carries out directly, it and related government entities provide various types of law enforcement or legal assistance to individuals, community organizations, and state and local law enforcement agencies. That assistance can take the form of direct payments to individuals; financial grants to carry out projects or conduct research; information, training, or services; or in-kind grants. This option would reduce direct financial assistance by 20 percent while removing many of the restrictions on the use of those justice assistance grants. In addition, it would eliminate funding for the Legal Services Corporation (LSC) and terminate the State Justice Institute (SJI). Those cuts can, of course, be considered separately.

In 1995, the federal government will provide state and local units of government and nonprofit organizations with justice assistance grants totaling about $315 million. That financial assistance is spread among many grant programs, each earmarking funds for a specific purpose. Consolidating those grants into one large formula grant for justice-related activities and reducing the total funding by 20 percent would generate outlay savings of $14 million in 1996 and $238 million through 2000 measured from the 1995 funding level. (Savings would be $14 million in 1996 and $258 million through 2000 measured from the 1995 level adjusted for inflation.) For 1995, the Congress appropriated $415 million to fund the LSC and $14 million to fund the SJI. Reducing funding for those two organizations as described below would save $369 million in 1996 and $2.1 billion over the 1996-2000 period measured from the 1995 funding level ($382 million in 1996 and $2.3 billion through 2000 from the 1995 level adjusted for inflation).

Reduce and Consolidate Direct Financial Assistance. The DoJ provides grants to states and localities, most of which are distributed through the Bureau of Justice Assistance. One of the largest programs is the Anti-Drug Abuse Grants program. Other grants fund juvenile justice programs; support research, development, and evaluation of state justice programs; assist in the settlement of Cuban and Haitian immigrants; or fund various other initiatives. Grants are classified and administered as either program grants, which are awarded to governments or nonprofit groups based on competitive applications, or formula grants, which allocate funds on the basis of population and other characteristics of the states.

Critics of federal spending for law enforcement assistance argue that DoJ directs much of its funding toward problems that are of low priority to recipient governments or that are not federal responsibilities. They also contend that resources are used inefficiently and that with some modification, financial assistance could be scaled back substantially with no detrimental effects on the nation's law enforcement capabilities. The reductions contemplated by this option would entail consolidating the programs and

changing the method by which funds are allocated. Most DoJ grants are categorical grants, which must be used for a specific purpose and in some cases require the receiving entity to provide matching funds. Specifying the grant's purpose could encourage units of government to spend money on programs that may not be a high priority in their jurisdiction. (From that point of view, applicants take grants because they are available rather than because of pressing need.) In contrast, block grants are dedicated to a broad category, and recipients are allowed to direct resources toward the programs within that category where they need is greatest. Shifting the method of distributing funds exclusively to block grants would enhance the ability of localities to handle their law enforcement problems, even with fewer total resources.

Those people in favor of restructuring the federal government's grant programs also point to potential savings from lower administrative costs. Currently, each program grant requires that applicants file a proposal detailing how the grant will be used and what oversight will be conducted; in addition, recipients must submit follow-up reports on the program's achievements. Those administrative expenses absorb a portion of the total grant that could be used to carry out program activities by administering the entire program as a single formula grant. This plan is consistent with recommendations in the National Performance Review for reducing administrative overhead and enhancing flexibility.

Opponents of reducing funding for law enforcement point to the vital role of the federal government in augmenting the resources of the states and directing funds to areas of critical national need. In certain cases, they argue, the problems that those funds are addressing are national in scope; without the incentive of federal grants, the states might neglect those problems because of the scarcity of their resources. For example, state and local law enforcement agencies use the Anti-Drug Abuse Grants for street-level drug enforcement, and in 1991, that one program accounted for roughly 10 percent of such spending by all levels of government. Without federal assistance, these advocates assert, the nation's streets would be far more dangerous than they already are. With crime rates soaring around the country, they argue that there should be more, rather than less, federal money allocated to battling crime.

Other areas, such as juvenile justice, also rely heavily on federal assistance for support. In many cases, states supplement federal funds with their own resources, thus raising the total level of resources directed at the problem. Reducing federal funding for those efforts would cause many of the states to terminate their programs and allocate their funds to other purposes. Proponents of the current categorical grant system maintain that if such grants are used effectively, they can provide the necessary incentive for states to address problems that federal lawmakers feel are most pressing. These advocates argue that the purpose of the grants is not to provide the resources for law enforcement efforts at all levels of government but to persuade states and localities to address problems that they otherwise might not. The federal effort to persuade states to enhance their civil rights protections is an example of how that practice has operated in the past.

Eliminate Funding for the Legal Services Corporation and Terminate the State Justice Institute. The Legal Services Corporation is an independent, not-for-profit organization that supplies funding to programs providing free legal advice to the poor on civil matters. About 300 state and local programs receive LSC grants from federally appropriated funds, and in 1992 those programs handled about 1.4 million cases. Since its inception in 1974, the LSC has been the subject of controversy. Critics such as the American Farm Bureau Federation charge that the activities of legal service lawyers too often focus on advancing social causes rather than on meeting the needs of poor people with routine legal problems; they also question the appropriateness of some of the tactics employed by LSC attorneys. In addition, such critics argue that providing legal services to the poor is not a federal responsibility. If funds for the LSC were eliminated, the responsibility for legal aid to the poor would rest with states and local governments. That change would make those services more responsive to local needs.

Those people in favor of continued support for the LSC argue that the federal government's funding of free legal services for poor people is the only way to ensure that all citizens receive legal representation, regardless of their financial situation. Removing federal funding in favor of support from private sources and pro bono services would diminish access to legal

services. Proponents of the LSC argue that relying on uncertain and indirect forms of assistance, rather than on a specifically targeted program of federal assistance, is insufficient protection; the inadequacy of local and private support was one of the factors that led to direct federal financing in the first place. In addition, proponents point out that criticisms of the LSC have subsided in the past few years as a result of its eliminating some of its more controversial activities. They argue that thorough oversight and clear definition of permitted activities would further curtail the activities that some observers find objectionable while still achieving the LSC's purpose.

The State Justice Institute was established in 1984 as a private, not-for-profit corporation to provide grants and undertake other activities to improve the administration of justice in the states. Although the President proposed terminating this program in 1995, the Congress appropriated $14 million for it. According to critics, the SJI has a negligible impact on the functioning of state justice systems. Most of its grants support research on improving the administration of justice, particularly the courts, but the SJI does little to disseminate or spur implementation of the results of those studies. Critics say the SJI's funds would be more effective if they were used to aid justice systems in implementing ideas that have been shown to work, rather than to produce more research. Opponents further argue that the institute has no effect on how justice systems function and that terminating it would cause no noticeable decline in services. Termination would, however, produce savings from the 1995 funding level of $4 million in 1996 and $53 million through 2000. (Measured from the 1995 funding level adjusted for inflation, savings would be $4 million in 1996 and $57 million through 2000.)

SJI proponents argue that it is a useful source of new ideas for improving state justice systems and a forum for officials of different state and federal agencies to exchange innovative ideas. They point to useful projects that the institute has funded, such as the one that reduced the length of trials in San Jose from eight days to four, as examples of how the SJI's work has improved the administration of justice. Proponents further assert that the SJI is one of only a few institutions that focus on the courts, a critical element in any criminal justice system. They argue that without enhanced court administration, improvements in other areas of law enforcement cannot achieve their full potential.

DOM-60 LIMIT SALARY INCREASES FOR FEDERAL CIVILIAN EMPLOYEES

Savings Compared with Full Raises under Current Law	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
			Grant No Raises in 1996			
Budget Authority	3,101	2,692	1,421	1,058	921	9,193
Outlays	2,965	2,709	1,476	1,073	927	9,150
			Grant Only ECI Raises			
Budget Authority	1,283	2,737	4,087	5,531	7,168	20,806
Outlays	1,227	2,674	4,028	5,468	7,097	20,494
			Grant Only Locality Raises			
Budget Authority	1,184	3,231	4,680	5,315	5,547	19,957
Outlays	1,133	3,142	4,616	5,287	5,536	19,714

NOTES: Savings exclude reductions in agency contributions to federal employee retirement trust funds because those reductions do not affect the deficit.

In order to show the effect of the specific programmatic changes in this option, savings are calculated relative to spending that has been projected under the assumption that current laws and policies affecting this activity remain unchanged. Those current-law estimates differ from projections that are not based on any programmatic assumptions and simply assume that the 1995 level of spending for this activity (or that amount adjusted for inflation) is provided in every year.

In 1995, the payroll for the government's roughly 2 million civilian employees in all three branches of government will total about $90 billion, or roughly 6 percent of total federal outlays for the year. (Those figures do not include postal workers.) In the past, largely in response to budgetary pressures, the government has acted to reduce federal personnel costs, and the Congress could take such action again. Three of many options are described here.

The estimated budgetary impact for each option depends on assumptions about what would have happened otherwise under current law--that is, a baseline assumption. The estimates thus compare the cost of each option with the cost of granting the full raises provided for under the Federal Employees Pay Comparability Act of 1990, or FEPCA. Under FEPCA, federal white-collar workers may receive two pay adjustments at the start of each year (see Table 3-2). The first is meant to keep changes in federal salaries at about the level of changes in private-sector pay, as measured by the employment cost index (ECI). The second is intended, over a period of nine years, to close existing gaps between federal and private-sector rates on a geographic ("locality") basis. If these raises were granted in full, they would push the federal civilian payroll to more than $110 billion in 2000. (That estimate assumes savings from reductions in employment under the Federal Workforce Restructuring Act of 1994.) The options described below would limit the growth of payroll by the amounts indicated in the table showing annual savings. Much greater reductions in pay raises and employment than are assumed here would be needed to reduce the government's payroll below its level in 1995.

The main argument for holding down scheduled pay raises casts such action as part of a general belt-tightening necessitated by the federal budget deficit. Constraints on spending are not confined to the federal government; financially strapped firms in the private sector and local governments have been forced to cut personnel costs through layoffs, pay limits, or other measures. In the past, limits on pay would have raised major concerns about the ability of

the federal government to recruit and retain workers. But such concerns appear less urgent with personnel reductions already under way throughout government. Nonetheless, restraints on pay impair the government's ability to retain high-quality workers, although generous benefits may help offset the impact of low pay. Moreover, should agencies experience trouble in hiring and keeping the workers they need, FEPCA offers a means to provide allowances, bonuses, and special pay rates that could help agencies deal with the worst of their problems. (The savings in outlays listed above assume that those special clauses in FEPCA would not be activated.)

The main argument against limiting raises is based on concerns about fairness and worker morale, given the sacrifices that federal employees have already had to make on behalf of the budget. Before the enactment of FEPCA, federal employees were entitled to annual adjustments under procedures that compared federal and private-sector salaries nationwide. In the past decade, increases have been held well below the level needed to achieve comparability with the private sector. Moreover, restricting pay would represent a revival of the same kinds of practices that led to the need for FEPCA and would undercut that long-deliberated reform. Data collected under FEPCA continue to show that federal pay rates lag behind comparable private-sector rates: after years of pay limitation, federal workers, on average, are paid from 20 percent to 40 percent less. (The percentage varies for different occupations, grade levels, and locations of employment.) Failing to close those gaps inevitably narrows the pool of candidates for federal work and could eventually impose unacceptable burdens on agencies that are trying to get the employees they need to get work done. Should agencies resort to special pay measures to address such problems, the fragmentation and complexity of the federal pay system would greatly increase.

Table 3-2.
Pay Raises Under FEPCA (In percent)

	1996	1997	1998	1999	2000
ECI-Based Raises	2.40	3.20	3.10	3.00	3.00
Locality Raises	3.37	2.59	2.37	2.42	2.47

SOURCE: Congressional Budget Office.

NOTE: The cost to the government of locality raises is somewhat less than the percentages listed above because employees who receive special supplements to their pay do not get full locality raises.

Provide No Raises in 1996. Under this option, the government would skip both of the raises under FEPCA for 1996 only. Savings would accumulate to $9.2 billion over five years. Relative to the other options presented here, this option represents a more temporary departure from FEPCA. Federal salaries would still eventually reach comparability, but some of the raises required to get there would occur after 1996. That outcome occurs because granting no adjustments for a year increases the pay gap in later years, resulting in higher locality raises at that time.

Grant Only ECI Raises. Alternatively, the government could grant only ECI-based adjustments similar to those under FEPCA. This option would save $20.5 billion over five years. The approach essentially accepts current pay gaps: federal rates would keep pace with *changes* in salaries outside government but would never catch up. (To that end, CBO's estimate assumes that the government grants the full ECI adjustment rather than the lower amounts under FEPCA.) In abandoning the principle of comparability, the government could drop its costly, controversial annual process for determining comparability raises that it has seldom granted. The government could always reopen the question of comparability for federal salaries at a later date.

Grant Only Locality Raises. This approach would save $19.7 billion over five years. (The estimate assumes that workers who are in pay plans that are not eligible for locality raises would get ECI adjustments as a substitute.) Granting only locality raises would represent less of a departure from current law--if not from actual practice--than the previous options. As under the option to skip raises in 1996, federal salaries under this plan would still eventually reach comparability, but some of the raises required to get there would shift to later years.

DOM-61 REDUCE THE NUMBER OF POLITICAL APPOINTEES

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	47	34	66	109	113	368
Outlays	45	34	65	107	112	363

NOTES: Savings exclude reductions in agency contributions to federal employee retirement trust funds because those reductions do not affect the deficit.

In order to show the effect of the specific programmatic changes in this option, savings are calculated relative to spending that has been projected under the assumption that current laws and policies affecting this activity remain unchanged. Those current-law estimates differ from projections that are not based on any programmatic assumptions and simply assume that the 1995 level of spending for this activity (or that amount adjusted for inflation) is provided in every year.

Generally, the term "political appointee" refers to employees of the federal government who are appointed by the President, some with and some without confirmation by the Senate, and to certain policy advisors hired at lower levels. For the purposes of this option, the term covers cabinet secretaries, agency heads, and other "executive-schedule" employees at the very top ranks of government; top managers and supervisors who are noncareer members of the Senior Executive Service; and confidential aides and policy advisors who are referred to as Schedule C employees. Total employment in such positions, according to CBO projections, will average about 2,800 over the next five years. If the government instead capped the number of political appointees at 2,000, savings over the 1996-2000 period would total $363 million. (Savings measured against the 1995 funding level would be greater, because the number of political appointees projected for that year is larger than the five-year average on which CBO's estimates are based.) The average salary for political appointees in the CBO calculations is estimated to be $86,000.

The National Performance Review (NPR) called for reductions in the number of federal managers and supervisors but made no specific reference to those managers and supervisors who were political appointees. Yet the argument that the NPR put forth for reducing the number of government managers--that they add to organizational layering and complexity and therefore stifle initiative and limit flexibility--also applies to top managers who are political appointees. In the same vein, the National Commission on the Public Service, also known as the Volcker Commission, called for a limit on the number of political appointees similar to the one described here. In addition to the problem of excess organizational layering, the commission described concerns associated with the lack of expertise in government operations and programs that characterizes many appointees. In political appointments, the commission noted, more weight is often given to political loyalties than to knowledge of government. Moreover, few appointees are in office long enough to acquire the necessary skills and experience to master their job. That lack of experience, wrote the commission, means that political appointees in many instances are not effective in carrying out the policies of the President they serve and can disrupt the day-to-day operations of agencies. Another consequence is that career managers become frustrated and demoralized, making recruitment and retention difficult at the top ranks of the career civil service.

Those observers who defend the use and proliferation of political appointees cite the importance for a President of establishing control over the vast bureaucracy by having like-minded individuals and allies strategically located throughout the government. These appointees, supporters note, form an important link to the electorate because they help to ensure leadership throughout government that is consistent with the philosophy of each elected President. Such appointees, moreover, can be a source of fresh perspectives and innovation. The high rate of turnover among many appointees, supporters argue, means that these officials make way for someone new before they reach the point of "burnout."

DOM-62 ELIMINATE THE ONE-DOLLAR BILL AND REPLACE IT WITH A NEW DOLLAR COIN

	Annual Added Revenues (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Additions to Current-Law Revenues	0	0	20	30	50	100

NOTE: In order to show the effect of the specific programmatic changes in this option, savings (shown here as added revenues) are calculated relative to spending that has been projected under the assumption that current laws and policies affecting this activity remain unchanged. Those current-law estimates differ from projections that are not based on any programmatic assumptions and simply assume that the 1995 level of spending for this activity (or that amount adjusted for inflation) is provided in every year.

The United States is one of the few industrialized countries that continues to use paper bills for sums as small as the equivalent of one dollar. Each year, the Bureau of Engraving and Printing within the Department of the Treasury manufactures billions of currency notes of all denominations, which are purchased by the Federal Reserve at cost. Depending on demand, dollar bills constitute approximately 45 percent to 50 percent of all notes produced annually. So many one-dollar notes must be printed and purchased because they lack durability: they circulate on average only 18 months before they must be retired. By contrast, the life-cycle costs of coins are substantially lower because they have lower handling expenses and may remain in circulation for up to 30 years. Eliminating the one-dollar note and replacing it with a new dollar coin would lower the costs of the Federal Reserve System and increase its earnings, which are remitted to the Treasury as miscellaneous receipts, reducing the deficit. Implementing this proposal would increase revenues by $100 million over the next five years. (Although savings here represent an increase in revenues, this option was not included in the chapter on revenues because it does not involve changes to tax policy.)

CBO's revenue estimate covers reductions at the Federal Reserve System in both purchasing and processing costs. Purchasing costs would decline because the Federal Reserve could forgo annual purchases of billions of one-dollar notes (although its purchases of two-dollar notes would increase). Processing costs would also drop because coins would not require the careful inspection for counterfeiting and fitness for circulation that notes now receive.

In addition to savings in costs, proponents of this option argue that a new dollar coin would have other benefits. Dollar coins would be easier for the visually impaired to distinguish and easier to use in most coin-accepting machines. They would also increase the speed of many cash register transactions.

However, some new costs would also be associated with a dollar coin. The U.S. Mint would require an additional appropriation to cover the costs of research and development, expansion of its coin production capacity, and a public awareness campaign to increase acceptability of the new coins.

Based on the government's unsuccessful efforts with the Susan B. Anthony dollar, critics of a new dollar coin argue that the United States would need to take certain strong measures to ensure the coin's acceptance. According to that view, the government would have to be prepared to eliminate the one-dollar note completely, ensure that the new coin's form was distinct from that of other coins, and promote it vigorously. Even so, critics contend that there is no guarantee that a new dollar coin would gain public acceptance. Coins are bulky, and commercial banks, which shoulder the majority of coin processing costs, would incur higher expenses. In addition, because coins are more expensive than bills to transport, the users of armored car services would sustain higher costs.

Nonetheless, most major European countries have overcome these obstacles. Valued at the current exchange rates, the smallest paper note denominations in Spain (500 peseta/$3.80), France (50 franc/$9.25), Germany (10 mark/$6.35), Switzerland (10 franc/$7.50), and Great Britain (5 pound/$7.80) are significantly more valuable than the one-dollar bill.

DOM-63 REDUCE THE OVERHEAD RATE ON FEDERALLY SPONSORED UNIVERSITY RESEARCH

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	398	398	398	398	398	1,990
Outlays	179	358	398	398	398	1,731
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	529	665	804	951	1,102	4,051
Outlays	238	537	714	856	1,005	3,350

Federal spending for research and development (R&D) performed at universities covers both direct and overhead costs (also known as indirect costs). The major direct costs of research are wages for scientists, engineers, and technicians, and payments for materials and specialized equipment. Overhead costs allocated to federal research include research-related administrative overhead, library and student services, buildings and equipment used in common, and operations and maintenance. The National Institutes of Health (NIH) accounts for roughly half of federally sponsored university research. The National Science Foundation and the Department of Defense are also major sources of federal funds.

To calculate the overhead expenses that can be allocated to federal research, universities typically take most, but not all, of their direct costs (known as modified direct costs) and apply a prenegotiated payment rate to them in each of several categories. The sum of the rates from all of those categories is the overall payment rate for overhead expenses. Overall overhead payment rates could be set and frozen for all universities at 90 percent of their 1995 level. If that option was implemented, it would save $179 million in 1996 and $1.7 billion over the 1996-2000 period relative to the 1995 funding level. Relative to the 1995 level adjusted for inflation, this option would result in savings of $238 million in 1996 and $3.3 billion over the 1996-2000 period. (The two sets of savings estimates differ because the inflation-adjusted level of funding for university R&D grants would have to be reduced to maintain the program at the 1995 funding level. Both sets of cuts would reduce the grant programs to the same level of funding in 2000.) To capture the savings from this option, the Congress must reduce the appropriations for university research by an amount corresponding to the mandated reduction in overhead costs.

The overhead payments for federally sponsored university research have increased faster than the direct costs of research, although that growth has moderated in recent years. In 1972, each dollar of direct research funding paid to universities carried an additional 30 cents to cover the overhead costs allocated to federal research. Over the next decade, the share of overhead costs rose rapidly, finally leveling off at around 45 percent beginning in 1985. In 1994, 44 cents in indirect costs were paid for each dollar spent on direct research costs. (Because payment rates are applied only to a portion of the total direct costs and because some agencies pay lower overhead rates for certain grants, the overall payment rate is higher than the ratio of overhead costs to direct costs.)

Overhead payments related to facilities have led the increase in costs, contrary to the impression given by well-publicized instances of questionable charges by universities to overhead payment accounts. Those charges have not been a major factor in the long-term growth of the share of overhead costs; in fact, auditors estimate that they account for only about 1 per-

cent of those costs. Increases in the costs of operating and maintaining facilities--utilities, repairs, and janitorial services--have been the major component of the escalation in facilities costs in the past decade. And growth has continued even in the face of substantial drops in the price of energy. Higher costs for new buildings as a result of higher real estate prices, construction inflation, and interest costs have not been as significant.

Given the leveling off of overhead rates since the late 1980s, many analysts have questioned the need for a special consideration of them. But that leveling has only been possible because of the pressure on administrative overhead expenses. Overhead rates for facilities costs have continued to rise throughout the 1990s.

The rise in the share of funding for federally sponsored university research that goes to pay for overhead has fostered a concern that each federal dollar spent is now producing less actual research activity. Freezing the payment for overhead costs at 90 percent of its current level is meant to allay that concern. It would also have the advantage of ensuring that no single university would experience a very large reduction. But the reduction would hurt small and state universities that have kept their overhead costs low.

Some people might argue that competition by universities for grants should be sufficient to control the growth of overhead, and that the increases in the share of those costs are an unavoidable outcome of market forces and reflect real cost increases. The market for university research, however, tends to be concentrated among a relatively small number of universities overall and to be very concentrated in specific research areas. Because only a few institutions contend for a large share of federal spending for university R&D, it may not be reasonable to assume that competition is enough to hold down overhead costs. The higher overhead rates charged by the largest private universities that are major recipients of federal support may indicate a lack of competition. (There is also some evidence that those schools may charge much lower overhead rates on private grants.) If competition is indeed lacking, regulatory rules are an appropriate response to ensure that federal dollars are spent in the most productive way. Capping overhead payment rates would supply the discipline that the market has been unable to provide and motivate some institutions to become more efficient and cost-conscious.

Defenders of the current system contend that the increases in the overhead costs of university research are legitimate and that the nation's system of research universities will be hurt if universities are not permitted to recover the total cost of the research they conduct. Financially strapped institutions could be forced to reduce investments in new facilities, library collections, and the like. In fact, the success seen since 1985 in slowing the growth of overhead costs can be attributed in part to reduced spending for libraries. If inadequate library resources reduce the effectiveness of universities in performing their research and education missions in the future, the near-term savings gained by controlling overhead costs may not be worth the loss of future benefits to society as a whole.

University advocates make other points as well. The higher overhead rates of large private universities may not be due to a lack of cost discipline; instead, because those institutions lack state government appropriations, they may simply be more assiduous in claiming all that is rightfully theirs. Another argument made against a reduction is that, because the data are lacking to determine the actual total costs of R&D, such a reduction could be set below the real cost-recovery point. Nevertheless, many in the research community would advocate reductions in the amount of overhead payments. However, they would apply the savings to increasing the number of research grants rather than reducing the deficit.

Other types of organizations in many cases charge even higher indirect rates than do universities on federal R&D grants. In 1994, for example, the NIH paid 51 percent in indirect costs to colleges and universities, but it paid 63 percent to research institutes, 57 percent to hospitals, and 56 percent to for-profit organizations. Not-for-profit organizations, by contrast, received 45 percent. In 1994, organizations other than colleges and universities accounted for 20 percent of NIH research grants.

An alternative to freezing overhead cost payments to colleges and universities is to reduce such

payments to other types of organizations to 90 percent of their 1995 levels adjusted for inflation. Because data on R&D grants are not collected for all federal agencies in the requisite detail, it is difficult to estimate savings with precision. However, if one assumes that other agencies spread grants among different types of recipients in patterns similar to those of the NIH, then capping the overhead rate on all federal grants at 90 percent of 1995 levels would save roughly $224 million in 1996 and $2.2 billion over the 1996-2000 time frame relative to the 1995 funding level. Relative to the 1995 level adjusted for inflation, this option would save $4.1 billion over the 1996-2000 period.

DOM-64 REDUCE SPENDING FOR THE HIGH PERFORMANCE COMPUTING AND COMMUNICATIONS PROGRAM

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
From the 1995 Funding Level						
Budget Authority	381	381	381	381	381	1,905
Outlays	147	292	364	381	381	1,565
From the 1995 Funding Level Adjusted for Inflation						
Budget Authority	419	460	503	548	594	2,524
Outlays	161	336	448	508	553	2,006

The High Performance Computing Act of 1991 established the multiagency High Performance Computing and Communications (HPCC) program to further the development of technology for supercomputers and high-speed computer networks and to increase their use throughout the U.S. economy. The program started with a base of preexisting individual efforts spread across several agencies. It has grown by increasing the funding levels of those base programs, by reclassifying other preexisting programs as part of the HPCC effort, and by starting new programs. At present, the HPCC program represents a large fraction of federal activities in high-speed computing and data communications. The multiagency effort costs a little more than $1 billion yearly. Cutting the program by 33 percent relative to the 1995 funding level would save $147 million in 1996 and $1.6 billion over the 1996-2000 period measured against that same level. Relative to the 1995 level adjusted for inflation, the option would save $161 million in 1996 and $2.0 billion in the 1996-2000 period. (The two sets of savings estimates differ because program services would have to be cut just to maintain the program at the 1995 funding level. Both sets of cuts would reduce the program to the same level of funding in 2000.)

The HPCC program is divided into five areas: supercomputer hardware, supercomputer software, high-speed computer networking, information infrastructure applications, and basic research and human resource development within the four previous areas. The reduction in the program under this option would cut across all categories and affect several agencies, most notably the Advanced Research Projects Agency (ARPA) of the Department of Defense, the Department of Energy (DOE), the National Aeronautics and Space Administration (NASA), and the National Science Foundation. To realize savings from the reduction, the Congress would have to decrease the appropriations for the agencies by the amount of the reduction.

The HPCC program is currently an amalgam of two types of projects: first, efforts to develop new computer and communications technology and second, end-user applications. Both types of projects appear in all of the program's technology areas. In the software area, for example, new algorithms and software concepts would be considered technology developments. By contrast, end-user applications would include NASA's funding of the development of software to help aircraft manufacturers design new airplanes more quickly and more cheaply. Not all of the end-user applications are commercial, but they are all specific uses of a particular technology. Some are demonstration projects.

The HPCC program had its origins in the technology development area. By refocusing its resources within that area, the program can make a unique contribution. End-user applications are an-

other matter. High-performance computing and computer communications markets continue to grow rapidly. Computer companies are competing fiercely to provide new and better products to meet demand. Given those dynamic market forces, proponents of program cuts would argue that the need for federal stimulation at the user end is greatly reduced, below the level needed even a few years ago.

This division of labor between federal and private efforts that such proponents would advocate follows from the government's previous experience in trying to move computer technology forward. Federal agencies under earlier policy initiatives made substantial contributions to high-performance computing and communications by funding the development of early proof-of-concept prototypes and components and supporting applied research at universities. Major advances by federal agencies in the high-performance computing arena included underwriting the research that led to the development of the first engineering workstation and high-speed, or RISC, computer architecture. Federal agencies also participated in the research leading to the use of high-performance computers to create visual images of scientific data to help scientists further understand data patterns. By contrast, the government's efforts to develop products for immediate end use, mainly hardware, have met with less success.

In some markets, the federal government is the major client--for example, for software to model the global climate. In those markets, programs responsible for tracking changes in the global climate may be the more appropriate source of funding for the development of the requisite software, rather than the federal technology development program. In some instances, reducing HPCC funds for end-user applications may result in increased costs in other program areas. Nevertheless, the value of those new applications and their true costs are probably best assessed within the programs that will use them. Restricting what the HPCC program pays for would help ensure that funds earmarked for technology development are actually devoted to that end and not funneled into other activities.

Opponents of reductions in the HPCC program argue that the field of computing advances by the use of specific applications. Cutting programs for developing applications might therefore slow the pace of development of computer technology. In addition, a strict distinction between technology development and applications development may be difficult to maintain in actual practice, especially for the first applications in a given area. Moreover, withdrawal of federal support may increase the commercial riskiness of developing new types of applications. Supporters of the HPCC program also argue that many institutional, regulatory, and historical obstacles are impeding the rapid development of markets for this technology; consequently, eliminating federal efforts in this area would slow its adoption. Proponents of program cuts counter that such obstacles might be best addressed directly. They further contend that any effort to develop end-user applications that does not address those obstacles could result in underutilized "prestige" projects.

As noted above, much of the recent growth in the HPCC program has not come from additional funds for new projects. In many cases, agencies took existing programs that had elements related to high-performance computing and began classifying them as part of the HPCC program, hoping to capitalize on the popularity of the field. In other instances, major programs with large components related to high-performance computing are not included in the HPCC program. Obviously, those outside programs, most notably in ARPA, DOE, and NASA, should be taken into account when deciding about reductions in the HPCC program.

DOM-65 MODIFY THE SERVICE CONTRACT ACT BY ELIMINATING THE SUCCESSORSHIP PROVISION

	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	200	210	220	220	230	1,080
Outlays	190	210	210	220	230	1,060

NOTE: In order to show the effect of the specific programmatic changes in this option, savings are calculated relative to spending that has been projected under the assumption that current laws and policies affecting this activity remain unchanged. Those current-law estimates differ from projections that are not based on any programmatic assumptions and simply assume that the 1995 level of spending for this activity (or that amount adjusted for inflation) is provided in every year.

The McNamara-O'Hara Service Contract Act of 1965 sets basic labor standards for employees on government contracts whose principal purpose is to furnish labor, such as laundry, custodial, and guard services. Contractors covered by this act generally must provide those employees with wages and fringe benefits that are at least equal to those prevailing in their locality or those contained in a collective bargaining agreement of the previous contractor. The latter provision applies to successor contractors, regardless of whether their employees are covered by a collective bargaining agreement.

The cost of services procured by the federal government could be reduced by permitting successor contractors to pay lower wage rates or to provide less costly fringe benefits than those provided by their predecessors. Under this option, successor contractors would still be subject to the rules on prevailing wages and fringe benefits. This change in requirements would reduce outlays by about $190 million in 1996 and by about $1.1 billion over the 1996-2000 period, provided federal agency appropriations are reduced to reflect the anticipated reduction in costs.

Federal procurement costs would fall because this option would promote greater competition among contractors. The current rule discourages potential successors from bidding on contracts in which the existing provider has a collective bargaining agreement, unless they have similar agreements.

The provision for successor contractors is intended, however, to prevent bidders from undermining existing collective bargaining agreements. Eliminating this provision would reduce the compensation of workers in some firms that provide services to the government. Some supporters of keeping the provision argue that a reduction in compensation would, in turn, reduce the quality of such services.

DOM-66 REPEAL OR MODIFY THE DAVIS-BACON ACT

	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Repeal Davis-Bacon						
Budget Authority	390	410	420	430	440	2,090
Outlays	150	430	600	690	770	2,640
Raise Threshold to $1 Million						
Budget Authority	140	140	150	150	160	740
Outlays	40	110	160	190	210	710
Raise Threshold to $250,000						
Budget Authority	60	60	70	70	70	330
Outlays	20	40	60	80	90	290
Change from Weekly to Monthly Wage Reporting						
Budget Authority	30	30	30	30	40	160
Outlays	10	30	50	60	60	210

NOTE: In order to show the effect of the specific programmatic changes in this option, savings are calculated relative to spending that has been projected under the assumption that current laws and policies affecting this activity remain unchanged. Those current-law estimates differ from projections that are not based on any programmatic assumptions and simply assume that the 1995 level of spending for this activity (or that amount adjusted for inflation) is provided in every year.

Since 1935, the Davis-Bacon Act has required that "prevailing wages" be paid on all federally funded or federally assisted construction projects with contracts of $2,000 or more. The procedures for determining prevailing wages in the area of a construction project, as well as the classifications of workers who receive them, favor union wage rates in some cases.

The federal government could reduce outlays for construction by repealing the Davis-Bacon Act or by modifying it. Repealing the act would reduce outlays by about $150 million in 1996 and by about $2.6 billion over the 1996-2000 period. Raising the threshold for determining which projects are to be covered by Davis-Bacon from $2,000 to $1 million would exclude about 31 percent of the value of all contracts currently covered by the act. Savings in that case would total about $40 million in 1996 and about $710 million over the five-year period. Raising the threshold to $250,000 would exclude about 12 percent of the value of all contracts and save about $290 million over the five-year period. Changing the requirements for wage-and-hour reporting for contracts covered by Davis-Bacon from a weekly to a monthly basis would reduce compliance costs for contractors by about $210 million over the five years. Each of these estimates assumes that the Congress would reduce federal appropriations for agencies to reflect the anticipated reduction in their costs of construction.

Repealing Davis-Bacon or raising the threshold for projects that it covers would reduce the cost of federal construction. In addition, either action would probably increase the opportunities for employment that federal projects might offer to less skilled workers. Such changes would, however, lower the earnings of some construction workers. Opponents of these options also argue that eliminating or relaxing

Davis-Bacon requirements could jeopardize the quality of federally funded or federally assisted construction projects. Reducing the requirements for wage-and-hour reporting would lessen the paperwork required of employers, but at the same time it might diminish the effectiveness of the Davis-Bacon Act by reducing the government's ability to detect noncompliance.

Chapter Four

Entitlements and Other Mandatory Spending

Entitlement programs provide benefits to all who are eligible to receive aid and choose to participate. Social Security, Medicare, Medicaid, food stamps, and farm price supports are major federal entitlements. Spending on these and other so-called mandatory programs (not including deposit insurance) accounts for more than one-half of all federal outlays. In 1995, this category is expected to cost $845 billion--about 12 percent of gross domestic product (GDP).

Under current law, outlays for mandatory programs are expected to increase at an average annual rate of 6.8 percent between 1995 and 2000. Under the Congressional Budget Office's (CBO's) baseline with discretionary spending adjusted for inflation after 1998, the rest of federal spending is projected to rise by an average of 3.4 percent a year during the same period. If current policies continue, entitlements could constitute nearly two-thirds of all federal spending by early in the next century. The aging of the baby-boom generation is expected to drive the fraction still higher over succeeding decades. Hence, the job of managing the growth of federal spending will be largely a matter of controlling the growth of mandatory outlays.

Spending on entitlement programs is primarily determined by the programs' rules that govern eligibility, the extent of participation, benefit levels, and the cost of providing noncash benefits, not by the annual appropriation process. A variety of other factors also increase or decrease outlays for entitlements, including demographic shifts, changes in providers' practices, and rates of inflation. Annual entitlement spending is, therefore, only partly under the direct control of the Congress.

The total that is spent on entitlements has grown rapidly since the early 1960s. As a share of GDP, however, much of the increase had already occurred by about 1975. Steadily increasing spending for retirement and disability programs, plus the creation of Medicare and Medicaid in 1965, spurred the growth of federal entitlement outlays from less than 6 percent of GDP in the early 1960s to about 11 percent in 1975. Since then, the share of national production committed to entitlement programs has grown more slowly and is expected to be about 13 percent by 2000.

Factors Underlying the Growth in Mandatory Spending

The largest force behind this continued growth in entitlement spending is the rapid rise in spending on Medicare and Medicaid. Although growth in these two programs has slowed in the past year, federal spending on them is expected to increase at an annual rate of about 10.3 percent between 1996 and 2000 if they are not changed. By contrast, spending on other entitlements is expected in grow at an annual rate of about 4.9 percent during that period without any

changes in those programs. One convenient way of analyzing growth in entitlement spending is to break it down by its major causes--growth in caseloads, automatic increases in benefits, growing use of medical services, and other factors (see Table 4-1).

Mounting caseloads account for about one-quarter of the growth in entitlement programs--driving up spending by an estimated $15 billion in 1996 and $68 billion in 2000, compared with this year's outlays. More than half of that growth is concentrated in the Social Security, Medicare, and Supplemental Security Income programs and is largely traceable to the continued "greying" of the U.S. population and the growing prevalence of disability. Much of the rest is in Medicaid. Among the three largest entitlement programs, caseload growth--even without any other changes--is expected to push up outlays in 2000 by 7 percent in relation to 1995 in both Social Security and Medicare and by 20 percent in Medicaid.

Automatic increases in benefits account for about one-third of the growth in entitlement programs. All of the major retirement programs grant automatic cost-of-living adjustments (COLAs) to their beneficiaries. COLAs, which are pegged to the overall consumer price index, are expected to average more than 3 percent a year through 2000. In 1995, outlays for programs with COLAs are already more than $400 billion, and COLAs are expected to add an extra $10 billion in 1996 and $80 billion in 2000. Recent studies have suggested that the consumer price index overestimates the true level of inflation that consumers face. A change in the methods of col-

Table 4-1.
Sources of Growth in Mandatory Spending (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000
Projected 1995 Spending	845	845	845	845	845
Sources of Growth					
Growth in caseloads	15	28	41	55	68
Cost-of-living adjustments	10	26	43	62	80
Other automatic increases in benefits[a]	6	15	24	32	41
Other increases in Medicaid and Medicare[b]	20	38	60	85	112
Other growth in average Social Security benefits[c]	5	8	11	15	20
Irregular number of benefit payments[d]	-3	0	0	0	5
Change in outlays of credit reform liquidating accounts	-1	-3	-4	-6	-7
Other	2	3	5	9	9
Total	53	117	181	252	327
Projected Spending	899	962	1,026	1,097	1,173

SOURCE: Congressional Budget Office.

a. Automatic increases in Food Stamp benefits, Medicare reimbursement rates, and the earned income tax credit under formulas specified by law.

b. All growth not attributed to caseloads and automatic increases in reimbursement rates.

c. All growth not attributed to caseloads and cost-of-living adjustments.

d. Supplementary Security Income and veterans' compensation and pensions will pay 11 months of benefits in 1996, 13 in 2000, and 12 in other years.

lecting data on prices or in calculating the index, or a legislative change that tied COLAs to something less than the increase in the consumer price index, could substantially reduce the projected costs of automatic increases in benefit programs.[1]

Several other programs--chiefly Food Stamps, the two Medicare programs (Hospital Insurance and Supplementary Medical Insurance), and the earned income tax credit (EITC)--are also automatically indexed to inflation (except for the EITC, the consumer price index is not the measure of inflation used for those programs). The first program pays annual adjustments according to changes in the Department of Agriculture's Thrifty Food Plan index. Medicare's payments to providers (primarily hospitals and physicians) also climb, by law, in step with specialized price indexes for the medical sector. Moreover, the maximum EITC payment and the income thresholds above which the EITC begins to be phased out are automatically adjusted for inflation. Those indexation practices contribute an extra $6 billion in outlays in 1996 and $41 billion in 2000. The Medicaid program, however, is not reflected in those figures. The federal government essentially pays an agreed-upon share of the bills submitted to it by state programs, which obviously rise with inflation. Unlike Medicare, however, Medicaid has no federal reimbursement schedules that rise automatically. Medicaid thus falls into a category of programs that are indirectly, not directly, linked to inflation.

Another third or so of the growth in entitlement spending stems from increases in Medicare and Medicaid costs that cannot be attributed to growth in caseloads or automatic adjustments in reimbursements. First, as noted, Medicaid grows with inflation even though it is not formally indexed. Second, the health programs have faced steadily rising costs per participant, a trend known in Medicare jargon as "use" or "intensity"--a combination of more services per participant, more technological sophistication, and so forth. That residual growth in Medicare and Medicaid is projected to be $20 billion in 1996 and $112 billion in 2000.

In most retirement programs, the average benefit grows faster than the COLA alone would explain. Social Security is a prime example. Social Security benefits are tied to retirees' earnings during their working years, adjusted for increases in the cost of living after they retire. Because earnings have gone up faster than the cost of living, the average benefit for a new retiree exceeds the average monthly check of a long-time retiree whose last earnings may have been a decade or two ago and who has been receiving only cost-of-living adjustments since then. In addition, the growth in women's participation in the labor force means that more new retirees get benefits based on their own earnings rather than a smaller spouse's benefit. In Social Security alone, such phenomena are estimated to add $5 billion in 1996 and $20 billion by 2000.

Depending on variations in the calendar, three programs--Supplemental Security Income and veterans' compensation and pensions--may pay 11, 12, or 13 monthly checks in a fiscal year.[2] That practice dampens outlays in 1996 and swells them in 2000. Finally, other growth in benefit programs has many causes, among them rising benefits for new retirees in the Civil Service, Military, and Railroad Retirement programs (fundamentally the same phenomenon as in Social Security); larger average benefits in unemployment compensation, a program that lacks an explicit COLA but pays amounts that are automatically linked to the recent earnings of its beneficiaries; and increases in family support costs, largely at the discretion of state governments. All of those factors together, however, contribute just $9 billion of the total increase of more than $300 billion between 1995 and 2000. In sum, growth in caseloads, automatic adjustments for inflation, and growing use of medical services are the prime factors that are expected to push up outlays for entitlement and mandatory spending by almost 40 percent between 1995 and 2000.

1. The potential overestimate of inflation by the index, and the possible savings from changing the index itself or the use of the index in adjusting benefits or taxes, is discussed in more detail in Congressional Budget Office, "Is the Growth of the CPI a Biased Measure of Changes in the Cost of Living?" CBO Paper (October 1994).

2. The number of monthly benefit payments made during a fiscal year depends on whether October 1, the first day of the fiscal year, falls on a work day. If October 1 falls on a weekend, October benefits are paid on the last working day of September.

The Balanced Budget Act

Federal spending on entitlements is also influenced by the Balanced Budget and Emergency Deficit Control Act of 1985 (Balanced Budget Act), which links legislated changes in spending on entitlements and other mandatory programs with legislated changes in governmental receipts. Under the act, an entitlement program can be increased only if another one is cut or taxes or fees are raised. Similarly, a tax can be cut only if another one is increased or if entitlement spending is reduced. This requirement, which is called pay-as-you-go, applies not to each new law individually, but to the total impact of all laws since 1990 that affect the relevant fiscal years.

This pay-as-you-go rule is qualified in several ways. For instance, increases in direct spending or tax cuts for designated emergencies are exempt from the requirement. That provision has only been used once--in March 1993, to extend Emergency Unemployment Compensation benefits. In addition, the Balanced Budget Act excludes the receipts and mandatory outlays of the Social Security retirement and disability trust funds from all calculations under the act, including the pay-as-you-go requirements. (Social Security is subject to its own set of rules, however, which are designed to maintain the balances in the trust funds.)

If the pay-as-you-go rule is violated, a sequestration--automatic cutbacks applying to nonexempt mandatory programs--must take place. But many of the major benefit programs, such as Social Security, federal employees' retirement, and most means-tested programs, are wholly exempt from the automatic cuts. In addition, other programs (including Medicare and Stafford student loans) are subject to limited cuts. These rules leave a relatively small portion of mandatory spending to bear the brunt of a pay-as-you-go sequestration.

Program Trends and Options

In addition to suggestions for curtailing spending in specific programs, broad approaches to restraining the growth of entitlement spending have been suggested. One would place a cap on spending; another would apply a means test to restrict eligibility for benefits.

Many proposals have surfaced in the past that are aimed at placing an enforceable cap on mandatory spending. Those generally would tie the growth of spending for individual programs to inflation and the increase in the size of the eligible population. Often a transitional growth factor would be added, allowing the new policy to be phased in. Most proposals would also establish an across-the-board sequestration procedure to prevent a breach of the cap. Many advocates of this approach, however, have not accompanied the call for a mandatory cap with policy proposals to achieve the reductions in individual programs that would be needed to avoid sequestration. And in many cases, such a sequestration would involve large percentage cuts in benefits.

An across-the-board sequestration of mandatory programs could not be carried out easily, particularly if it was large. Government benefit checks and other mandatory spending could not simply stop flowing after the cap was reached without disrupting the lives of millions of people. Agencies in the executive branch could estimate the likely shortfall resulting from the cap and adjust all future payments to account for the effect of the limit, but that would involve an enormous amount of bureaucratic discretion and uncertainty about which benefits would actually be provided. Moreover, the courts would probably be asked to respond to the conflict between the legislation that authorized the mandatory spending and a sequestration of that spending.[3]

Applying a means test to entitlement programs has also been suggested as a broad strategy for curbing the growth in this spending. One approach would control entitlements as a group through a form of means-testing under which benefits would be cut most for beneficiaries with the highest income. Several ways of carrying out this approach are discussed in ENT-68.

3. For more information on using an enforceable cap, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1994-1998* (January 1993), p. 92.

The other options in this chapter would reduce the growth of entitlement spending on a program-by-program basis. For example, new program rules could limit who qualifies for benefits or reduce the amount of benefits provided (for example, see ENT-09, ENT-26, ENT-48, ENT-55, and ENT-63) or could reduce payments to providers of services (see ENT-33 through ENT-40 and ENT-49).

Medicaid

Medicaid is a joint federal and state program that provides medical assistance for certain people with low income. Federal matching rates for payments for medical services under Medicaid are determined by a formula based on states' per capita income but can never be less than 50 percent or more than 83 percent. The overall matching rate amounts to about 57 percent of medical assistance payments. The federal government also pays 50 percent of most associated administrative costs and higher rates for some services.

Medicaid covers participants in such income support programs as Supplemental Security Income (SSI) and Aid to Families with Dependent Children (AFDC). Some other people who have slightly greater income, some who have high medical expenses, and selected groups targeted by recent program expansions--such as children and pregnant women in families with low income--are also covered. About 70 percent of Medicaid spending goes to the aged and disabled, although they represent about one-fourth of participants. A considerable portion of this money pays for long-term care services.

With projected federal outlays of $90 billion in 1995--more than 10 percent of entitlement spending--Medicaid dwarfs the other means-tested entitlement programs (see Table 4-2). Program outlays rose about 10 percent a year in the 1980s as a result of the rising costs of medical care, greater use of covered services, and expanded eligibility. Between 1989 and 1992, program growth shot up to an average annual rate of 25 percent. The unusually rapid growth was attributable to a number of factors, among them the recession, the rise of disproportionate share payments to hospitals, and states' efforts to shift activities funded with state-only dollars to the Medicaid program. The growth in Medicaid spending began to stabilize in 1993, and CBO expects that future growth will continue at about the pace of the 1980s. ENT-29 through ENT-32 and ENT-55 describe options that would control spending on Medicaid.

Other Means-Tested Entitlement Programs

In addition to Medicaid, means-tested entitlement programs include Food Stamps; Supplemental Security Income, which is for the aged, blind, and severely disabled; family support payments (primarily AFDC); pensions for needy veterans who are aged or disabled; child nutrition (such as the School Lunch Program); and the refundable portion of the EITC, which benefits low-income working families with children. At $104 billion in 1995, expenditures on other means-tested programs represent about 12 percent of entitlement spending.

In recent years, caseloads in the AFDC and Food Stamp programs increased significantly before stabilizing in 1994. During that period, real (that is, inflation-adjusted) AFDC benefit levels declined. Federal spending for the refundable portion of the EITC rose from about $1 billion in the early 1980s to $9 billion in 1993, largely as a result of the expansions included in the Tax Reform Act of 1986 and the Omnibus Budget Reconciliation Act of 1990 (OBRA-90). As a result of changes in OBRA-93 that increased benefits for families, spending for the EITC is projected to more than double, from $11 billion in 1994 to $23 billion in 1997, before leveling off. ENT-29, ENT-53, ENT-54, and ENT-55 would reduce federal spending on certain means-tested programs by targeting benefits more narrowly and limiting federal payments for administering some of those programs.

The subsidized component of the Federal Stafford Loan Program is another means-tested entitlement. Through it students can borrow to attend postsecondary educational institutions. The annual budgetary cost of Stafford loans--as well as that of other federal loan and loan guarantee programs--consists of the present value of current and expected fu-

Table 4-2.
CBO Baseline Projections for Mandatory Spending (By fiscal year, in billions of dollars)

	Actual 1994	1995	1996	1997	1998	1999	2000
Means-Tested Programs							
Medicaid	82	90	100	111	123	136	149
Food Stamps[a]	25	26	27	29	30	32	32
Supplemental Security Income	24	24	24	29	32	35	40
Family Support	17	18	18	19	19	20	20
Veterans' Pensions	3	3	3	3	3	3	3
Child Nutrition	7	8	8	9	9	10	10
Earned Income Tax Credit	11	17	20	23	24	25	26
Student Loans[b]	3	4	3	3	3	3	3
Other	3	3	4	4	5	5	5
Total, Means-Tested Programs	177	194	208	229	248	268	290
Non-Means-Tested Programs							
Social Security	317	334	352	371	390	411	433
Medicare	160	176	196	217	238	262	286
Subtotal	476	510	548	587	628	673	720
Other Retirement and Disability							
Federal civilian[c]	40	42	43	46	48	50	53
Military	27	28	29	31	32	35	37
Other	5	5	5	5	5	5	6
Subtotal	72	75	77	81	85	90	96
Unemployment Compensation	26	22	23	24	26	27	28
Other Programs							
Veterans' benefits[d]	18	17	17	18	19	20	21
Farm price supports	10	10	9	9	8	8	8
Social services	6	6	6	6	6	6	6
Credit reform liquidating accounts	-7	1	e	-2	-3	-6	-6
Other	11	11	11	10	10	11	9
Subtotal	37	45	43	41	39	39	39
Total, Non-Means-Tested Programs	612	651	691	733	778	829	882
Total							
Total Mandatory Spending	789	845	899	962	1,026	1,097	1,173

SOURCE: Congressional Budget Office.

NOTE: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as domestic discretionary spending; Medicare premium collections are classified as offsetting receipts.

a. Includes nutrition assistance to Puerto Rico.

b. Formerly known as guaranteed student loans.

c. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.

d. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

e. Less than $500 million.

ture subsidies for loans that originate in the specific year. Stafford loans are much less directed toward needy students than Pell grants, which are made by the main discretionary program providing aid to postsecondary students. CBO's baseline projections show program costs for Stafford loans and other student loans averaging about $3 billion through 2000. ENT-25 and ENT-26 would reduce the federal cost of Stafford loans by reallocating part of the cost to students and their families.

Social Security and Other Retirement and Disability Programs

Spending on Social Security, the largest entitlement program, is expected to be $334 billion in 1995 and to provide benefits to more than 43 million elderly and severely disabled workers and members of their families. Outlays for benefits have grown over the years as a result of the inclusion of new groups among those deemed eligible for benefits, more recipients among existing eligible groups, cost-of-living increases in benefits, and the higher real earnings--hence higher benefits--of newly retired workers. The Social Security Amendments of 1983 made major changes in the program to improve its financial standing. Although most changes involved financing and coverage, others delayed annual cost-of-living increases to recipients and made some benefits subject to taxation. The amendments also increased the age of eligibility for full retirement benefits from 65 to 67, phasing in the change during the first quarter of the next century.

Baseline projections for Social Security spending reflect the influence of the above factors on the program through 2000. The increase in the number of aged people benefiting from Social Security has slowed in recent years. Although that trend will continue for several more years, as the relatively small group of people born during the 1930s becomes eligible, it will be partially offset by the aging of the baby boomers as they move into their late 40s and early 50s, when disability incidence rates are higher.

Although the Social Security program has special rules under the Balanced Budget Act and is not included in the pay-as-you-go budget discipline, it nonetheless accounts for two-fifths of entitlement spending; cutting it would reduce the total budget deficit. Options to alter the program's benefit structure are considered in ENT-59 through ENT-62. In addition, restraint on the annual cost-of-living adjustment for Social Security is a major component of ENT-67, which considers all non-means-tested retirement and disability entitlements.

Other retirement and disability programs--which will cost $75 billion in 1995, or about 9 percent of entitlement spending--are dominated by the government's civilian and military retirement programs. Spending on these programs is influenced by factors similar to those affecting Social Security, and outlays are expected to increase at like rates in CBO's baseline. ENT-50 and ENT-67 contain options that would modify benefits for former federal workers.

Medicare

Medicare was among the fastest growing of the major spending programs during the 1980s, outpacing defense and Social Security and second only to net interest payments. It is expected to provide $176 billion in benefits in 1995 through two related programs: Hospital Insurance (HI), which covers certain costs of hospital stays and some other institutional services used by elderly and disabled enrollees, and Supplementary Medical Insurance (SMI), which primarily pays for the services of physicians and other providers of outpatient health care. Spending has been fueled in recent years not only by growth in the eligible population but also by increases in the intensity and cost of medical services used by enrollees. A number of legislative changes have been made in recent years to constrain program growth.

CBO projects that HI outlays will rise at a nominal rate of about 8.4 percent a year between 1995 and 2000 and that SMI costs will increase at a nominal rate of 12.9 percent a year. Thus, without change, Medicare will account for 24 percent of entitlement spending in 2000, compared with 21 percent in 1995. ENT-33 through ENT-41 and ENT-49 consider a variety of options to limit payments to providers of medical services; ENT-42 through ENT-48 discuss several ways of increasing beneficiaries' payments.

Aid to Jobless Workers

Two entitlement programs that provide assistance specifically to unemployed workers are the federal/state unemployment compensation (UC) program and the much smaller federal Trade Adjustment Assistance (TAA) program. CBO's baseline for the UC program projects slow growth between 1995 and 2000, rising to around $28 billion in 2000. Unemployment compensation is included in the federal budget, but state laws set most of the benefit and tax provisions in the regular state programs, which provide the vast majority of benefits. Thus, states can generally offset federal options that would reduce regular UC spending, and permanent budgetary savings cannot usually be attributed to federal changes in regular UC rules. As a result, this chapter does not include federal options limiting regular UC benefits.

The TAA program offers income-replacement benefits, training, and related services to workers unemployed as a result of import competition. In 1994, this program provided about $200 million in benefits and services to around 25,000 recipients. ENT-51 would eliminate the TAA program.

Non-Means-Tested Veterans' Programs

Veterans' benefits constitute another category of federal entitlement spending. CBO projects that non-means-tested entitlement spending for veterans' compensation, readjustment benefits, life insurance, and housing programs will total about $17 billion in 1995, or about 2 percent of all entitlement spending during that year. ENT-63 through ENT-65 would restrict federal spending on veterans' benefits by limiting eligibility for certain programs and raising costs to participants. In addition, ENT-62 would reduce Social Security disability payments for some people who also receive veterans' compensation.

Farm Price Supports

Farm programs support producers through direct cash payments, subsidies for exports, direct government purchases, and constraints on production and imports. Most farm programs are governed by the 1990 farm bill, which expires this year. The current support varies by commodity. Direct payments, which are the bulk of federal outlays, go to producers of corn and other feed grains, wheat, cotton, and rice. Most export subsidies are for wheat. The government purchases dairy products and constrains imports to support milk prices. The government also supports producers of peanuts, tobacco, and sugar by different combinations of production controls, import restraints, and price-supporting loan programs. For those crops and dairy products, most of the support farmers receive is through market prices that are kept artificially high by the government programs. Producers of livestock, fruits and vegetables, and many other crops receive no direct government assistance.

CBO projects spending for farm price and income support programs and other mandatory programs related to agriculture to be $10 billion in 1995, down from $11 billion in 1994 and $16 billion in 1993. The farm price and income support programs funded through the Department of Agriculture's Commodity Credit Corporation dominate this category of mandatory spending. (Agriculture also benefits from programs funded through appropriations. Such discretionary programs, including agricultural research and extension, some export promotion programs, and farm loan programs, are covered in Chapter 3.)

The deficit reduction options in this chapter focus on adjustments to current programs that would reduce net spending, rather than wholesale policy changes that might be considered during this year's farm bill deliberations. Although they would adjust rather than revamp current policy, the effects of some options are large. ENT-06, which would steadily reduce target prices for the major crops, for example, would cut Commodity Credit Corporation outlays by about 50 percent in 2000. ENT-07 through ENT-09 and ENT-13 through ENT-16 consider other ways to cut federal spending for the commodity support programs. ENT-10 through ENT-12 would lower federal outlays by cutting programs that subsidize or promote exports of farm commodities.

User Fees and Other Changes in Direct Spending

Fees can be charged to users of resources, facilities, or services provided by the federal government to raise funds to help pay for them and to promote their more efficient use. Options describing modified or higher fees in a variety of areas are included in this chapter (ENT-01 through ENT-05, ENT-17, ENT-18, ENT-21 through ENT-24, ENT-27, ENT-69, and ENT-70). For example, the federal government could index nuclear waste disposal fees for inflation or establish charges for airport takeoff and landing slots.

Receipts from fees would be treated under the Balanced Budget Act like spending changes in entitlements or mandatory programs if the legislation changing the fees originated in an authorizing committee. In that case, the added receipts from fees would be credited to the pay-as-you-go scorecard.

ENT-01 CHARGE MARKET PRICES FOR ELECTRICITY SOLD BY POWER MARKETING ADMINISTRATIONS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	0	1,000	1,000	1,000	1,000	4,000

Hydroelectric power generated at 129 federally owned plants is sold by power marketing administrations (PMAs), which are agencies of the Department of Energy. In recent years these federally owned hydroelectric plants have generated about 6 percent of the electricity sold in the United States. Under current law, the PMAs must first offer to sell most of this power to rural electric cooperatives, municipal utilities, and other publicly owned utilities (collectively known as preference customers). Any excess PMA power not purchased by preference customers can be sold to investor-owned utilities. Current law requires that these sales be made at cost. This option would eliminate the requirement to offer PMA power first to preferred customers and would allow the PMAs to sell it to the highest bidder. It would also eliminate requirements that the Bonneville Power Administration give preference to consumers in the Northwest over other regions and acquire electricity to meet demands by its customers.

The federal government charges an average of about 2.5 cents per kilowatt-hour (kwh) for this power. PMA electricity prices vary widely among hydroelectric projects. In 1994, PMA wholesale electricity prices ranged from 3.25 cents per kwh to less than 1 cent per kwh. Determining the market value of PMA power at each of the government's hydroelectric projects would require open competition among preferred customers, privately owned utilities, and new customers. As a preliminary estimate of the market value of PMA power, the Congressional Budget Office looked at the average price of non-PMA wholesale power transactions in regions of the country served by the PMAs. The average price for this power was about 4.5 cents per kwh in 1992.

By eliminating the public power preference and selling the power to the highest bidder, the federal government could increase annual power receipts by about $1 billion. The additional revenues could be used by the PMAs to repay the $14 billion cost of constructing existing plants. In addition, the current practice of selling power below market rates leads to levels of electricity consumption in PMA service areas that are inconsistent with the government's energy conservation and environmental objectives.

Conversely, critics of this option argue that large rate increases that could result from it would adversely affect regional economies. Those who would continue to reserve PMA power for use by public utilities maintain that this is a more appropriate use of the government's hydroelectric resources than allowing private companies to profit from the sale of public resources. Proponents of the status quo also say that publicly owned utilities have encouraged widespread use of electricity (especially in rural areas) at low rates.

ENT-02 IMPROVE PRICING FOR COMMERCIAL AND RECREATIONAL USES OF PUBLIC LANDS

Addition to Current-Law Receipts	Annual Added Receipts (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Raise Grazing Fees	5	13	17	17	17	69
Reform Federal Water Policies	15	15	25	30	30	115
Raise Recreation Fees at Federal Facilities	175	172	181	188	196	912

The federal government owns and manages nearly 650 million acres of land in the United States. This land is used for a wide variety of purposes, including grazing, recreation, and water reclamation. For most commercial and some recreational uses, the government is compensated--often by fees. In some cases, those fees may not provide the government with a fair return, and underpricing may lead to overuse. Better pricing could increase federal receipts and alleviate overuse by reducing commercial and recreational activity.

Grazing Fees. The Forest Service and the Bureau of Land Management administer the practice of livestock grazing on approximately 262 million acres of public rangelands in the West. Those lands provide ranchers with approximately 31,000 grazing allotments and, at current leasing rates, approximately 20.9 million animal unit months (AUMs) of grazing each year. In 1990, the appraised value of public rangeland in six Western states varied between $5 and $10 per AUM. A 1993 study indicated that the Forest Service and the Bureau of Land Management spent $4.60 per AUM to manage their rangelands for grazing. By contrast, the 1994 permit fee was set at $1.98 per AUM under the fee formula established by the Congress. The weighted average lease rate for grazing on private lands in the 11 Western states in 1993 was $10.03 per AUM. Thus, the current fee structure may represent a subsidy for many of the ranchers who participate in the program and creates a wide disparity between public and private charges for grazing.

Various proposals have been introduced in the Congress to increase the grazing fee. These proposals would either adjust the fee-setting indexes to reflect livestock markets and private rangeland leasing rates, or replace the existing fee structure with a new, modified market value. The increase in federal receipts resulting from either of these measures depends on the degree to which ranchers reduce the size of their grazing stock as a result of the increased fees.

A recent proposal called for an annual increase in the grazing fee. Under the proposal, the fee would reach $3.96 per AUM over a period of three years. The fee would then be tied to a forage value index based on private land rents. The proposal would also impose a 20 percent to 50 percent levy on ranchers who lease their grazing rights to others and grant a 30 percent reduction in the fee to permit holders participating in rangeland conservation programs. These modifications would lead to an increase in federal receipts, measured against current law, of approximately $69 million during the 1996-2000 period. These figures are the amounts that would be left in the Treasury after deducting the additional receipts that would be paid to states and counties as a result of increased grazing fees, but they do not reflect any additional appropriations for range improvements that could result from added receipts.

Increased fees for grazing on public lands may overstate the value of those lands when compared with private properties that might be in better con-

dition or offer more favorable lease terms. In addition, low fees may encourage permit holders to invest in range improvements and to practice good stewardship over the land by grazing only at permitted levels. A potential disadvantage of increased fees is that they would cut ranchers' profit margins and thus might encourage them to break the grazing limits and forgo range improvements. Between 1979 and 1983, however, ranchers spent, on average, only 16 cents per AUM per year for range improvements. Increased funding from the Range Betterment Fund would offset any decrease in private range improvements. Providing ranchers with longer-term leasing agreements, regardless of their fee level, could promote efforts to combat overgrazing.

As an alternative to setting fees, grazing rights could be allocated through a competitive bid process similar to the system used by the Bureau of Indian Affairs. Disadvantages of this approach are high administrative costs and limited competition. In many cases, only the owners of private lands adjacent to federal lease tracts would be willing to bid for grazing rights. (Current law requires permit holders to own a base property near the federal lease tract). Permit holders do not normally have complete control over third-party access to the permit area. Thus, permit holders may hope to maintain control by owning and regulating the private lands surrounding the lease tract.

Water Sales. The Bureau of Reclamation's primary purpose is to provide water for agriculture in the Western states. Irrigation water is made available through long-term contracts with water districts that are composed of individual farmers. Water prices charged under these contracts are generally much lower than the true market value of the water. In agriculture, the charges rarely cover the federal costs associated with water projects. Federal water is often provided at less than its full cost for some agricultural commodities, such as cotton, which are subject to price support programs.

In recent years, the Congress has considered several reforms aimed at increasing receipts from agricultural users of federal water and reducing subsidies to those users. Many of these reforms were enacted for the Central Valley Project (CVP) in California, the largest of the bureau's projects. Among other provisions, the Central Valley Project Improvement Act of 1992 (CVPIA) set aside water for fish and wildlife, introduced a graduated pricing system for agricultural users of CVP water, imposed environmental surcharges on all CVP water use, and allowed water transfers. There are, however, other opportunities for price reform that the act does not address.

One reform would require farmers receiving federal irrigation water under new or renewed water contracts to pay the full cost of that water if they use it to grow commodities for which they receive crop price support payments. Another reform would require that farms of more than 960 acres be charged the full cost of federal irrigation water. (Current law contains that requirement but is often circumvented because of the vague definition of the term "farm.") These two reforms are examples of changes in the current system that could increase savings when irrigation water is supplied by the federal government. Under provisions of the CVPIA, which are not yet in effect, California farms that receive CVP water--including a majority of farms larger than 960 acres--will pay the full cost for approximately 10 percent of their water. Restructuring pricing for water sold outside the CVP and applying full-cost prices to the remaining 90 percent of the CVP water allocations would increase federal receipts from water sales. Reducing commodity program payments throughout the West would produce additional savings. Taken together, these reforms could increase receipts by at least $95 million during the 1996-2000 period. Commodity program payments could decrease by $20 million during the same period, for total savings of $115 million over five years.

Recreation Fees. All federal agencies that hold major tracts of land allow recreational access and provide some visitor services. The services range from maintaining rough hiking trails to operating fully developed recreational facilities, such as campsites and marinas. Entrance and user fees are charged at some locations. The Congress approved new and expanded fees for 1994, but they will still cover only a small portion of the direct service costs. For example, in 1995, the National Park Service will spend an estimated $237 million on visitor services and will recover less than $71 million in fees. Requiring the Park Service to charge fees to cover these direct costs as well as associated collection costs would shift that

burden to the beneficiaries of the services and improve pricing of public land use. Such fees would lower net federal outlays by $175 million in 1996 and by $912 million over five years.

Arguments against additional increases in fees reflect the view that the national parks and public lands are a vital and accessible part of our national heritage. The social benefits of visits to the parks--especially for the elderly and the poor--far exceed the government costs. Visits should be encouraged, not discouraged by increasing fees.

Additional increases, however, would shift the costs of police protection and other services from the taxpayers to the users of parks. The overcrowding that is now a problem at many parks could be alleviated by an appropriate fee structure. And visits by the poor and the elderly could be encouraged by free-access days or the cross-subsidization of urban parks, by which fees collected at some parks would be used to offset the costs of maintaining others that have lower charges or none at all.

ENT-03 CHANGE THE REVENUE-SHARING FORMULA FROM A GROSS-RECEIPT TO A NET-RECEIPT BASIS FOR COMMERCIAL ACTIVITIES ON FEDERAL LANDS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	170	180	185	190	195	920
Outlays	135	175	180	190	195	875

The federal government owns nearly 650 million acres of public lands--nearly one-third of the U.S. land mass. These public lands contain a rich supply of renewable and nonrenewable natural resources: timber, coal, forage for livestock, oil and natural gas, and many nonfuel minerals. Private interests are given access to much of the federal land to develop its resources. Generally, private parties pay fees to the federal government based on the commercial returns realized. In many cases, the federal government allots a percentage of those receipts to the states and counties containing the resources, as compensation for tax revenues they did not receive from the federal lands within their boundaries.

The federal government typically calculates the allotments to states and counties on a gross-receipt basis before taking account of its program costs. This practice has an important disadvantage: providing federal receipts-sharing on a gross rather than a net basis sometimes causes the federal government's program costs to exceed its share of receipts.

In most cases, the U.S. Forest Service is required to allot 25 percent of its gross receipts from commercial activities in the national forests to the respective states and counties. The Department of the Interior allots 4 percent of its timber receipts, an average of 18 percent of its grazing fees, and 4 percent of its mining fees from "common variety" materials to the states; the Department of the Interior, specifically the Minerals Management Service (MMS), allots 50 percent of its adjusted onshore oil, gas, and other mineral receipts to the states. (The MMS deducts 50 percent of its administrative costs from the gross-receipt calculation before distributing those payments. In effect, the states share 25 percent of the burden of these administrative costs.) On certain federal lands--specifically, national forests affected by protection of the spotted owl and the Oregon and California grant lands--payments to states and counties are made on the basis of an average of payments made in the past.

Federal savings would be substantial if the Congress required these agencies to deduct their full program costs from their gross receipts before paying the states. The regional jurisdictions would continue to receive the same allotted percentage of net federal receipts and would accrue receipt shares totaling about $670 million in 1996.

Certain federal costs could increase, however, under the federal Payment in Lieu of Taxes (PILT) program, which was established in 1976 to offset the effects of nontaxable federal lands on the budgets of local governments. These PILT payments to the states are partially reduced by the amount of revenue-sharing payments from federal agencies. Payments under the PILT program would increase if net program receipts were shared and the Congress appropriated such an increase. These additional payments have been netted out of the projected savings. Changing the revenue-sharing formula from a gross-receipt to a net-receipt basis would reduce net federal outlays by $875 million over the 1996-2000 period.

Changing the revenue-sharing formula to a net-receipt basis would, in all probability, have a negative impact on the economies of the respective states and counties. A significant source of revenue for some states and counties would be reduced. That reduction in revenues might lead to serious cuts in state and county spending. To help alleviate that hardship, the federal agencies could switch gradually to the net-receipt basis over a period of several years.

ENT-04 INDEX NUCLEAR WASTE DISPOSAL FEES FOR INFLATION; ELIMINATE THE DEFERRED PAYMENT OPTION

Addition to Current-Law Receipts	Annual Added Receipts (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Index Fees for Inflation	19	40	64	86	110	319
Collect Deferred Payments	0	880	1,100	0	0	1,980

The Nuclear Waste Policy Act of 1982 established the Nuclear Waste Fund (NWF) to finance the development of storage and permanent disposal facilities for spent nuclear fuel and high-level radioactive waste; the first permanent repository is not expected to open before 2010. In April 1983, the Department of Energy published a rule requiring electric utilities to pay one mill (one-tenth of a cent) into the fund for each kilowatt-hour of electricity sold from a nuclear power plant. The rule provided three payment options for the fees assessed on nuclear power generated before April 1983, one of which was to pay a lump sum with accrued interest before a utility shipped its first wastes for disposal.

The one-mill fee has remained constant since the rule's inception, although the general price level (measured by the gross domestic product deflator) has risen more than 45 percent since 1983. Based on current Congressional Budget Office projections, annual inflation adjustments starting in 1996 would raise $319 million over five years.

The primary arguments in favor of this proposal are that the current fee may be insufficient to finance the necessary disposal facilities, especially because inflation has eroded its value, and that indexing equitably allocates the costs between present and future operators of nuclear power plants (and their electricity consumers). A June 1990 study by the General Accounting Office argued that historically plausible inflation and real interest rates (4 percent and 3 percent, respectively) could produce a present-value shortfall of $2.4 billion in 1988 dollars--approximately 10 percent of total system costs--if the fee remains fixed.

The Energy Department argued against automatic indexing in a November 1990 report, asserting that its revenue estimates show the fund roughly in balance; that given present levels of uncertainty, the fund may in fact be collecting too much money; and that occasional "step" adjustments in the fee, introduced as new information is acquired, would be a better way to avoid problems of under- or overfunding.

Another proposal would affect the 13 (out of 70) nuclear utilities that have so far avoided paying any fees or interest for pre-1983 electricity because they selected the deferred payment option. The fees amount to $880 million, and interest charges through September 1994 total $975 million. Requiring the utilities to pay the fees by 1997 and the interest by 1998 would raise about $2 billion, including the post-1994 interest. Such a requirement might also be fairer to the 57 utilities that have already paid their fees on pre-1983 electricity, perhaps in part because they accepted the government's initial timetable for opening a repository by 1998.

One argument against eliminating the deferred-payment option is that shifting receipts from the future (albeit an uncertain point in the future) to the present has no real impact on federal indebtedness. Another is that the purported gain in fairness is either illusory or wrongly conceived. If investors believe that fees and interest will in fact have to be paid at some point, the market values of the 13 utilities presumably already reflect these NWF liabilities; and if the utilities have benefited from a shrewd choice of payment option, it would not be fair to reduce that benefit by changing the rules in midstream.

An additional argument against both proposals to increase NWF receipts maintains that annual utility payments already exceed the amount being spent to develop the waste disposal facility. Cumulative spending from the fund through 1994 was $4 billion, less than half of total collections of $8.2 billion. Similarly, the President's budget request for 1995 anticipated new net receipts from utilities of $551 million (and $320 million from interest income on the fund's balance), compared with its appropriation request of $255 million. Some observers believe that the nuclear waste program could use more money. Given current plans, however, increases in receipts would reduce the federal deficit but are not needed to accommodate the program's near-term growth.

ENT-05 CHARGE ROYALTIES FOR HARDROCK MINING ON FEDERAL LANDS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	0	70	70	70	70	280

The General Mining Law of 1872 governs access to hardrock minerals---gold, silver, uranium, copper, molybdenum, and most other metals--within the boundaries of public lands. Any holder of more than 10 unpatented mining claims must pay a maintenance fee of $100 a claim. In addition, all claimholders must pay a $25 location fee when recording a location notice for an unpatented claim. Currently, the federal government collects no royalties for the production of hardrock minerals on federal lands. Once minerals are determined to be economically recoverable, the claimholder may apply to buy (patent) the claim by paying the federal government $2.50 or $5 per acre, depending on the type of claim, plus a small application fee.

Legislation to reform the Mining Law of 1872 has been introduced in the Congress for at least the last three sessions. Most recently, in the 103rd Congress, the House of Representatives approved H.R. 322. The Senate had already approved a mining reform bill--S. 775. Both were aimed at reforming the hardrock mining system to bring it into line with the leasing system currently used for exploring and developing oil and gas on federal lands. Under the proposed laws, mining operators on public lands would have to share the profits of mineral production with the federal government by paying a royalty based on the value of minerals produced. In addition, the Administration placed a one-year moratorium on patenting, thus temporarily thwarting mining operators who try to escape royalties by buying the land.

Estimates place the value of hardrock mining production on federal lands at more than $1.2 billion a year, if new patents continue to be issued. The Congressional Budget Office (CBO) estimates that an 8 percent royalty as proposed in H.R. 322 would yield additional receipts totaling about $90 million a year, beginning in 1997. Assuming that states where the production takes place receive 25 percent of this income, the federal Treasury would retain about $70 million annually.

It is difficult to estimate royalty receipts because it is uncertain how the imposition of fees would affect hardrock mining on federal lands. In order to prepare these estimates, CBO assumes that some claims would be relinquished and some production on federal lands would be cut back, at least in the short run.

Those in favor of mining law reform--primarily the environmental community--argue that because the current fees for maintaining a claim on public land are nominal, too much land is tied up in mining. They say that although the principle of free access may have been effective in encouraging the settlement of the West and the production of vital minerals, free access is no longer necessary to ensure development. Also, they argue that royalties will compensate the federal government for the use of public lands and for extraction of minerals from them.

Proponents of mining reform further argue that charging a price for the use of federal lands and their resources will encourage the mining industry to focus on those lands most likely to yield profitable returns. That will free land for other public purposes, such as recreation and wilderness conservation. In addition, a portion of the receipts from royalties could be dedicated to the reclamation of land after mining has been completed.

Opponents of mining law reform--primarily the mining industry--argue that in the absence of free access, exploration for hardrock minerals, particularly by small miners, would decline. They also ar-

gue that royalties, by increasing costs to an industry that is already operating close to the margin of profitability, would lower development of minerals and adversely affect regional economies. Since many mineral prices are determined on a world market, mining operators would be unable to pass along most of the royalty and holding fee costs to consumers. Thus, some mines would shut down and set off economic ripples throughout their regions.

Finally, those who are opposed to reform contend that developing a system to collect fees and monitor mining activities more closely would be expensive to administer.

ENT-06 REDUCE DEFICIENCY PAYMENTS TO FARMERS PARTICIPATING IN USDA COMMODITY PROGRAMS BY LOWERING TARGET PRICES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	501	1,380	2,380	3,338	4,151	11,750
Outlays	501	1,380	2,380	3,338	4,151	11,750

Farmers who participate in federal commodity programs--those who produce corn and other feed grains, wheat, rice, or cotton--receive a deficiency payment, which is the primary form of direct government subsidy to growers. The size of the deficiency payment is calculated in part from the difference between the market price of a crop and a target price. (Table 4-3 shows the target prices set by current law through the 1995 crop year. The Congressional Budget Office baseline assumes that target prices are maintained at these levels for the 1996-2000 crop years.)

Budgetary savings could be achieved by reducing target prices in the years after 1995. The greater the rate of reduction, the greater would be the savings. One alternative would be to reduce target prices by 3 percent a year starting with the 1996 crops (see Table 4-3). Outlay savings would be an estimated $11.75 billion over the 1996-2000 period.

An advantage of reducing target prices is that such a reduction would increase the degree to which farmers respond to market prices, rather than to government program benefits, in making their production decisions. Market prices are better guides to efficient use of resources than are government program benefits.

Lower target prices would reduce farm income by reducing direct government payments. Farm income would not fall by as much as government outlays because some farmers would offset part of the loss by not participating in the commodity programs. Farmers leaving the programs would lose all of their government payments, but they would no longer be required to limit the amount of land planted in particular crops, nor would they need to adopt conservation practices required of participants. And if grain production increased, livestock producers might benefit from lower feed costs.

Despite an improved outlook for agricultural markets, many farmers are still facing financial difficulties. In some cases, financial problems were heightened by droughts or floods in recent years. Further reductions in target prices would intensify these difficulties.

Table 4-3.
Target Crop Prices Under CBO Baseline Assumptions and Under 3 Percent Annual Reductions (By crop year)

	1995	1996	1997	1998	1999	2000
			CBO Baseline Assumptions			
Wheat	4.00	4.00	4.00	4.00	4.00	4.00
Corn	2.75	2.75	2.75	2.75	2.75	2.75
Rice	10.71	10.71	10.71	10.71	10.71	10.71
Cotton	0.729	0.729	0.729	0.729	0.729	0.729
			3 Percent Annual Reductions			
Wheat	4.00	3.88	3.76	3.65	3.54	3.43
Corn	2.75	2.67	2.59	2.51	2.43	2.36
Rice	10.71	10.39	10.08	9.77	9.48	9.20
Cotton	0.729	0.707	0.686	0.665	0.645	0.626

SOURCE: Congressional Budget Office.

NOTE: Wheat and corn in dollars per bushel; rice in dollars per hundredweight; cotton in dollars per pound.

ENT-07 ELIMINATE THE 0/85-92 AND 50/85-92 PROGRAMS FOR PARTICIPANTS IN USDA COMMODITY PROGRAMS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	161	292	341	369	359	1,522
Outlays	161	292	341	369	359	1,522

Current law allows participants in U.S. Department of Agriculture (USDA) price and income support programs to receive 85 percent of their deficiency payments, even though they may plant as little as 50 percent of their eligible acreage in the program crop (the 50/85 program available to cotton and rice producers), or even though they do not plant any of the program crop (the 0/85 program available for wheat and feed grain producers). Participants who are prevented from planting by natural conditions can receive 92 percent of their deficiency payments. Producers must leave the land idle or, under certain conditions, may plant minor oilseeds such as sunflower, flaxseed, and canola. This option would eliminate these programs. Producers would have to plant the program crop to receive deficiency payments. In the 1994 crop year, almost 12 million acres went unplanted in the program crops under the 0/85-92 or 0/50-92 programs.

Eliminating these programs would save $1.5 billion over the 1996-2000 period. This estimate assumes that the Secretary of Agriculture would increase the acreage reduction program requirement for each supported crop if it was anticipated that eliminating the 0/85 and 50/85 programs would increase plantings. Participation in the acreage reduction program, under which producers agree not to plant a portion of their eligible land in the supported crop, is voluntary and unpaid. Producers must participate, however, to receive deficiency payments and other program benefits.

Eliminating these programs (and maintaining production at a given level by increasing the acreage reduction programs) would in effect substitute unpaid acreage reduction for paid acreage reduction. The Secretary of Agriculture has considerable discretion to increase unpaid acreage reduction requirements under the current outlook for program commodities, and proponents of this option would argue that there is no need to pay farmers to cut acreage. The programs that would be eliminated by this option were introduced at a time when unpaid acreage reduction requirements were high, and the Secretary had little discretion to increase them.

Opponents of eliminating these programs might argue that such a move would constitute "recoupling" program benefits with planting decisions, encouraging farmers to plant some land that might better be left idle from the perspective of market returns alone.

ENT-08 RAISE THE PROPORTION OF EACH FARMER'S BASE ACREAGE INELIGIBLE FOR DEFICIENCY PAYMENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Raise Ineligible Acres to 20 Percent of Base						
Budget Authority	222	391	464	458	446	1,981
Outlays	222	391	464	458	446	1,981
Raise Ineligible Acres to 25 Percent of Base						
Budget Authority	444	781	927	915	892	3,959
Outlays	444	781	927	915	892	3,959

Outlays of the Commodity Credit Corporation could be reduced by raising the number of acres ineligible for deficiency payments. Raising the proportion of land ineligible for payments from 15 percent to 20 percent of base acres would save $222 million in 1996 and nearly $2 billion over the 1996-2000 period. Raising ineligible acres to 25 percent of base would save $444 million in 1996 and nearly $4 billion over the 1996-2000 period.

Currently, wheat, feed grains, cotton, and rice producers who participate in commodity programs receive a deficiency payment. The size of the deficiency payment is generally equal to the difference between the target price for the commodity and its market price, times the program yield assigned to the farm, times "payment acres." Payment acres equal 85 percent of the farm's crop acreage base, less land idled to comply with the acreage reduction program that is in effect for the crop during that crop year. This option would expand the changes made in the Omnibus Budget Reconciliation Act of 1990 by decreasing the amount of land eligible to receive deficiency payments. Producers would be permitted to plant any program crop or oilseed on this additional unpaid acreage without losing eligibility for future program benefits. These changes would be introduced to reduce program spending and to increase the flexibility that farmers have in making planting decisions in response to the needs of the market rather than the rules of the farm programs.

A disadvantage of this option is that it would decrease farm income for most participants in commodity programs and for people raising crops that do not directly receive federal support. Program participants would shift some production away from program crops on land no longer earning subsidies and toward alternative crops. As a result of these changing production patterns, the incomes of growers of nonprogram crops would be hurt by the new competition.

ENT-09 RESTRICT ELIGIBILITY FOR BENEFITS FROM PRICE SUPPORT PROGRAMS AND REDUCE THE PAYMENT LIMITATION

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Limit Payments to $50,000 per Person						
Budget Authority	51	91	106	105	104	457
Outlays	51	91	106	105	104	457
Limit Payments to $40,000 per Person						
Budget Authority	148	267	309	306	304	1,334
Outlays	148	267	309	306	204	1,334
Disqualify People Whose Adjusted Gross Income from Nonfarm Sources Exceeds $100,000						
Budget Authority	41	73	85	84	83	366
Outlays	41	73	85	84	83	366
Disqualify People Whose Gross Revenue from Commodity Sales Exceeds $500,000						
Budget Authority	79	142	165	163	162	711
Outlays	79	142	165	163	162	711

Current law limits participants in crop price support programs to no more than $100,000 in deficiency payment benefits from the Commodity Credit Corporation during any crop year. The maximum in deficiency payments that can be received is $50,000 for an individual, plus $25,000 for a shareholder in a maximum of two corporate farms (each of which is entitled to a maximum payment of $50,000). The maximum of $100,000 can be achieved only by people who are actively engaged in the operations of relatively large farms and who have organized their farm businesses to maximize government payments.

Government costs could be reduced by allowing each farm operator to receive only the individual payment and eliminating the two corporate farm payments. This option would reduce spending by an estimated $457 million during the 1996-2000 period. Outlays could be cut further by reducing the maximum direct payment from $50,000 to $40,000, with estimated savings totaling $1.3 billion over the 1996-2000 period.

Eligibility for payments could also be limited on the basis of income or gross sales. Disqualifying people with adjusted gross income from nonfarm sources over $100,000 would save $366 million over the period. Disqualifying those with gross revenues from commodity sales over $500,000 would save an estimated $711 million over the period.

Support for these changes is based on the belief that current payment limits are too high. If reductions in program spending are required, they should come from relatively large farming operations rather than relatively small ones. In addition, reducing the limit on direct government payments would reduce their influence on the production decisions of operators of large farms, causing them to be more responsive to market returns. Operators of smaller farms, who are more likely to need government assistance, would continue to receive program benefits.

This change could harm farm operations of relatively efficient size. In addition, until operating and

price subsidies are reduced for producers in foreign countries, increasing the exposure of the most efficient U.S. farmers to market forces could hurt long-term prospects for the farm sector. Finally, the ability of some farmers to reorganize their holdings to avoid the payment limitations reduces the effectiveness of the limitation and increases the uncertainty of the estimated budgetary savings.

ENT-10 REDUCE LOAN GUARANTEES MADE UNDER THE USDA'S EXPORT CREDIT PROGRAMS BY ELIMINATING GUARANTEES FOR LOANS TO HIGH-RISK BORROWERS

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	-229	244	230	222	214	681
Outlays	-229	244	230	222	214	681

The U.S. government guarantees short- and intermediate-term loans made by commercial banks to finance foreign purchases of U.S. agricultural commodities and products. The government requires that borrowers be creditworthy. The purpose of these programs is to encourage exports of U.S. goods. Credit terms, in addition to price, are an important element of competition in world markets.

When a foreign buyer misses a loan payment, the bank making the original loan submits a claim to the U.S. Department of Agriculture. The USDA reimburses the bank, takes over the loan, and attempts collection. The U.S. government guarantees 98 percent of the principal of the loan, except loans to the republics of the former Soviet Union. In these loans, the government has guaranteed 100 percent of the principal.

This option would limit annual guarantees to $3.3 billion--about $750 million less than assumed under current law. The estimate of savings assumes that the entire reduction would derive from eliminating the guarantees for loans to the republics of the former Soviet Union, which are now considered to be the world's most risky borrowers receiving guarantees. Although Russia has, at times, been ineligible for additional credit guarantees, the Congressional Budget Office (CBO) estimate for current-law spending assumes that Russia will be eligible for new credit guarantees in 1995 and beyond. Eliminating these guarantees would increase government outlays in the first year because U.S. exports of price-supported agricultural commodities would decline. CBO assumes that in each of the following years, an increase in the acreage set-aside would compensate for the lost exports by lowering production. On balance, this change would reduce outlays by $681 million over the 1996-2000 period.

Proponents of reducing guarantees of credit would argue that they are overused and potentially extremely costly. The benefits of the first several billion dollars in guarantees--in terms of export promotion--may be substantial, but the net benefit diminishes, particularly since the additional guarantees are extended to countries that are at high risk of default.

Opponents of reducing credit guarantees argue that they are vital in retaining the U.S. share of competitive world markets. Opponents also argue that these guarantees are an important part of necessary aid to the republics of the former Soviet Union; CBO assumes that under current law they will receive $750 million in guaranteed credit during 1996. (Some supporters of more aid to these countries, however, would prefer that they be given commodities, rather than sold them with money loaned at high risk of default.) In addition, some agricultural producers believe that total exports and the prices that they receive for their commodities would be substantially lower without these credits.

ENT-11 ELIMINATE THE EXPORT ENHANCEMENT PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	257	946	838	730	617	3,388
Outlays	257	946	838	730	617	3,388

The U.S. Department of Agriculture (USDA) subsidizes the export of agricultural commodities through the Export Enhancement Program (EEP). U.S. exporters participating in the EEP negotiate directly with buyers in a targeted country, then submit bids to the USDA for cash bonuses. The bids include the sale price, tentatively agreed to with the buyer, and the amount of the subsidy or bonus requested by the exporter.

The signatories of the Uruguay Round agreements of the General Agreement on Tariffs and Trade have agreed to reduce the volume of subsidized exports of, and budgetary outlays on export subsidies for, agricultural products. Although the Uruguay Round agreements will restrict the EEP, which the United States has used to compete with the subsidy programs of other countries, they will not eliminate the program. Moreover, the legislation to carry out the agreements removes the requirement in U.S. law that the EEP be used as a response to unfair trade practices, so that it can be used more generally for market promotion and expansion.

Since its inception in 1985, the EEP has paid $7 billion in bonuses, mostly to assist wheat exports. Eliminating the program would save about $3.4 billion during the 1996-2000 period.

On the one hand, the EEP may help to increase U.S. exports or maintain market share. On the other, it is not clear how effective the program has been as a counterweight to foreign subsidies, or how effective it will be under a broader mandate. Moreover, some critics argue that the EEP has depressed world commodity prices, thereby penalizing competitors who do not subsidize their exports.

ENT-12 ELIMINATE THE MARKET PROMOTION PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	13	91	110	110	110	434
Outlays	13	91	110	110	110	434

The Market Promotion Program (MPP) was authorized under the 1990 Food, Agriculture, Conservation, and Trade Act to assist U.S. agricultural exporters, particularly when they faced unfair trading practices abroad. (The Uruguay Round Agreements Act stipulates that MPP assistance need no longer be aimed at the unfair trading practices of other countries.) Payments are made to offset partially the costs of market building and commodity promotion undertaken by state-related, private nonprofit, and private profit-making firms. The MPP has continued the Targeted Export Assistance Program, which was aimed mainly at specialty crops such as fruits and nuts, but has also selected wine, plywood, feed grains, meat, eggs, and several other agricultural products for promotion. Based on current law, the Congressional Budget Office assumes that $110 million will be spent annually for the program in the 1996-2000 period. Eliminating it would reduce outlays by $434 million over the next five years.

An argument for eliminating MPP funding is that the assisted groups benefit directly from the market development activities and thus should bear the full costs. The practice of subsidizing brand-name advertising by private firms in particular has come under fire. In addition, marketing funds are provided through other Department of Agriculture activities, such as the cooperator program of the Foreign Agricultural Service. Moreover, agricultural goods receive a disproportionate share of all federal funding for activities promoting U.S. exports.

However, eliminating the MPP could place U.S. exporters at a disadvantage in international markets. People concerned about U.S. exports of high-valued agricultural products consider the program a useful tool for developing markets for these products.

ENT-13 REDUCE COSTS FOR THE DAIRY PRICE SUPPORT PROGRAM BY INCREASING PRODUCER CONTRIBUTIONS

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	122	160	227	262	193	964
Outlays	122	160	227	262	193	964

The income of dairy producers is protected and increased through the purchase of storable dairy products by the U.S. Department of Agriculture's (USDA's) dairy price support program. Their income is further supported by marketing orders, which set minimum prices for milk designated for various uses. The dairy industry is also protected from foreign competition, although the degree of protection is being reduced to comply with the Uruguay Round agreements.

Consumers may benefit because the dairy price support program helps to stabilize prices of milk and milk products. Some needy families, schools, and other institutions gain through the free distribution of dairy products that are purchased by the USDA. The program raises the prices of dairy products, however, and thus consumer costs, above the levels they would reach without government intervention.

One method of reducing the costs of dairy programs would be to increase the assessments levied on dairy farmers' production. The current assessment averages $0.1125 per hundredweight of milk marketed. (Producers who do not expand production from one year to the next may have their assessments rebated. The rate of assessment charged producers whose output is expanding would be increased to maintain the average at $0.1125 per hundredweight.) The average assessment is scheduled to decline to $0.10 per hundredweight in 1996. Increasing assessments to $0.25 per hundredweight starting in January 1996 would save an estimated $964 million over the 1996-2000 period.

This method of reducing dairy program costs would be straightforward and relatively easy to administer. Many dairy producers favor this approach to cutting program costs over such alternatives as reducing federal price supports. A cut in the price support level for milk would cause a drop in the price that both consumers and the government pay for milk and milk products. Government purchases account for a relatively small portion of the total dairy market. Thus, in order to generate a significant amount of savings, the price cut would have to be relatively large. By contrast, an assessment would apply to the marketing of all milk. Therefore, a relatively small assessment would generate significant savings. As a result, the income of dairy farmers would be reduced less by the assessment than by a cut in support prices generating similar budgetary savings.

Raising these assessments, however, would reduce the net incomes of dairy farmers. Furthermore, the dairy industry would be paying part of the costs of purchases by the federal government of dairy products, much of which are used in domestic food assistance programs. Some people would argue that this assistance should be paid for by the taxpayer rather than the dairy industry. Moreover, raising the assessment would further penalize expanding operators, many of whom may achieve greater efficiency by growing or may be younger farmers trying to attain an efficient size.

ENT-14 REFORM MILK MARKETING ORDERS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	149	166	173	119	62	669
Outlays	149	166	173	119	62	669

Minimum prices paid by processors and handlers for most milk produced in the United States are regulated by federal milk marketing orders that evolved from legislation first enacted in the 1930s. The intended effect of these regulated prices is to increase returns to dairy farmers and stabilize supplies and prices of milk for fluid use.

The milk marketing orders and the milk price support program of the Department of Agriculture (USDA) are interrelated. The price support program provides a floor for prices of manufacturing-grade milk by buying milk products (cheese, butter, and nonfat dry milk) if their prices fall below specified support levels. Marketing orders set minimum prices that must be paid for milk for fluid use, based on the manufacturing-grade price plus differentials that are unique to each of the nearly 40 regional orders.

This option would eliminate marketing orders regulating the price of milk. The average price received by dairy farmers would decline as a result, reducing their income and causing shifts in the pattern of production and processing throughout the country.

Proponents of deregulating the prices of milk claim that original rationales for regulating prices--apart from increasing producers' income--no longer justify federal intervention in the market for milk. The regulations were introduced when long-distance transportation of milk was prohibitively expensive. At that time, moving milk from one area to dampen price swings in other areas was often impossible.

Local production, even in areas where production costs are high, is encouraged by the classified pricing system to ensure adequate supplies at reasonable prices.

Conditions have changed since the government introduced marketing orders. Now, with improvements in road systems and refrigerated transportation and changes in production technologies and consumption patterns, many analysts believe that regulated markets are no longer needed. Furthermore, using technology to reconstitute fluid milk--now discouraged by the regulated pricing system--would cut transport costs dramatically. Production would locate in the more efficient areas. That would lower milk prices for consumers. Greater variation in consumer prices might result, although fluid milk makes up a much smaller proportion of the food budget now than in the past. And benefits originally attributed to more stable prices would be less than at the time these regulated prices were first imposed.

This option would leave intact the USDA's milk price support program but would reduce its outlays by about $669 million over the 1996-2000 period. Spending would fall because eliminating pricing regulations would cut average prices received by farmers, which would discourage milk production and reduce government purchases of dairy products. The USDA's price support program would continue to protect incomes of dairy producers, but at lower levels than under current law.

ENT-15 INCREASE PRODUCER ASSESSMENTS TO PARTICIPANTS IN FEDERAL PROGRAMS SUPPORTING PRICES OF SUGAR, PEANUTS, AND TOBACCO

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	13	75	72	75	75	310
Outlays	13	75	72	75	75	310

Government programs aid producers of sugar, peanuts, and tobacco by supporting domestic prices above world market levels. These commodities are bolstered by a combination of import restrictions, domestic production controls, and price-supporting loans. As part of its efforts to cut total farm program spending, the federal government has imposed "assessments" on producers of these commodities. The assessments equal about 1 percent of the value of loans or marketing. Annual receipts from the assessment in the sugar program total about $33 million. The total assessment for peanuts is about $12 million annually, and for tobacco, about $28 million.

Net federal outlays vary for the programs supporting these crops. The Congressional Budget Office projects that under current law the sugar program will have no other net direct outlays--loan outlays are repaid within the fiscal year, so net outlays for the year equal receipts from the assessments. Net outlays for the peanut program have been negligible in the recent past, but are expected to range between $63 million and $91 million during the 1996-2000 period. The rise is caused by lagging repayments and increasing volumes of production entering the price-support loan program at annually increasing loan rates (the per-unit loan allowed by law). The tobacco program may have substantial outlays in a given year--1994 outlays were $693 million--but if the program functions as intended, no net cost to the government is expected.

This option would double the current assessments on domestic producers in the sugar, peanut, and tobacco programs. Doubling these assessments would bring in receipts of about $310 million over the 1996-2000 period.

Deficit reduction is the main benefit of increasing these assessments. Proponents argue that government programs give producers of these commodities substantial benefits, although the support is not in the form of direct payments. They argue that program beneficiaries should not escape the deficit reduction efforts experienced by producers of other supported commodities just because the mechanism of support is indirect. Opponents would argue that since these programs add little to the federal deficit, producers should not be assessed to reduce the deficit.

ENT-16 ALLOW HAYING OR GRAZING ON LAND IN ANNUAL SET-ASIDES AND IN THE LONG-TERM CONSERVATION RESERVE PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	80	92	89	100	91	452
Outlays	80	92	89	100	91	452

The Department of Agriculture usually requires participants in the support programs for wheat, feed grains, cotton, and rice to idle a portion of their land. Farmers receive no direct compensation for this but do get payments and other benefits based on production on the remainder of their land. Moreover, under provisions of the support programs, producers may voluntarily idle additional acreage and maintain a substantial portion of their program benefits. The idled land could be grazed or used to produce hay, which would increase the income of participating farmers. Current law, however, restricts such uses. The amount of land idled in the annual programs varies. During crop year 1994, about 13 million acres were idled. During crop year 1995, the Congressional Budget Office expects farmers to idle about 17 million acres.

The federal government also normally prohibits haying and grazing on land in the long-term Conservation Reserve Program. Participants in this program receive annual rental payments in exchange for agreeing to idle their land and maintain a protective vegetative cover. About 36 million acres are now in the conservation reserve. The Secretary of Agriculture can make exceptions to the haying and grazing prohibitions on conservation reserve land and that idled in the annual programs when weather or market conditions warrant.

This option would allow farmers to use some of this idled land for haying or grazing in exchange for a fee or a reduction in other government payments. The per-acre charge would be set according to local market rental rates for haying or grazing. Federal outlays would thus be reduced by an estimated $452 million over the 1996-2000 period. Savings would come from two sources: first, from the receipts from (or reduced payments to) farmers who want to hay or graze their land; second, from a reduction in costs of the price and income support programs for corn and other feed grains. The expansion of haying and grazing would cause a small decrease in the demand for corn and other feed grains. That would result in a slightly higher requirement in the Acreage Reduction Program, thereby reducing program outlays.

Proponents of allowing haying and grazing argue that a properly run program would allow farmers to use U.S. agricultural resources more efficiently with little reduction in the environmental benefits of current programs. (Land that is especially fragile environmentally would not be eligible for haying and grazing in this option.) In the past, many farmers, particularly in the southern Great Plains, have argued that grazing on land idled in the annual wheat program is an important source of feed. They also claim that it allows a more orderly marketing of cattle because this forage becomes available in the spring.

Some farmers and ranchers could take advantage of the opportunity to graze cattle on the otherwise unused land. These include livestock operators in the Southern and Northern Plains. About one-half of Conservation Reserve Program enrollees in these areas, for example, now have livestock facilities. Some of these operators could expand their enterprises, although lack of water and questionable forage quality might limit growth in some areas. Land could also be grazed in portions of the western Corn Belt, where water availability is less of a problem. Farmers who have the opportunity, facilities,

and expertise to establish or expand herds in these areas could benefit from allowing grazing. Farmers who can produce and market hay could also benefit.

Opponents argue that such a change would seriously endanger environmental benefits, particularly those derived from the Conservation Reserve Program. Grazing or haying could reduce the density of the protective cover crop and increase the possibility of environmental damage. Allowing haying and grazing could also greatly reduce the wild animal habitat protected by environmental programs.

Some farmers and farm groups would also object to this option. Commercial hay producers would face new competition. Producers of feed grains would lose some of their market as more forage became available. Livestock producers--other than those directly benefiting--might see a reduction in prices.

ENT-17 INCREASE FCC USER FEES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	72	75	78	81	84	390

Increasing the level of fees charged by the Federal Communications Commission to holders of FCC licenses could increase receipts by $72 million in 1996 and by $390 million from 1996 through 2000. The Congress passed legislation in the Omnibus Budget Reconciliation Act of 1993 that established new fees for certain types of licenses and increased fees for others. These increases raised approximately $60 million in 1994 and are expected to raise $95 million in 1995. The fees, however, are earmarked for specific regulatory costs and do not cover all regulatory activities or agency overhead.

People who favor increasing licensing fees argue that the fees would cover the full cost of the services that the FCC provides to license holders. These services include regulation, enforcement, rulemaking, and international and informational activities. A recent legislative proposal would set the level of fees on the basis of the equivalent of full-time employees rendering service. The level would be adjusted for such factors as coverage of license holders' service areas and whether a license provides for shared or exclusive use. The level of fees provided in this estimate would be sufficient to cover the inflation-adjusted cost of FCC activities. Fees would be set lower if the FCC was restricted to the level of its 1995 funding.

People who argue against increasing FCC fees hold that such increases would drive marginal operators out of business. Low-power AM radio stations, for example, often maintain very small profit margins. A significant increase in the license fee of such a small operator could be sufficient to force the station to close. This difficulty could be overcome by linking fee increases to station coverage area or broadcast power. Moreover, this problem is less significant to license holders outside the broadcasting industry.

ENT-18 CHARGE A USER FEE ON COMMODITY FUTURES AND OPTIONS CONTRACT TRANSACTIONS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	58	83	91	100	110	442

The Commodity Futures Trading Commission (CFTC) administers the amended Commodity Exchange Act of 1936. The purpose of the CFTC is to allow markets to operate more efficiently by ensuring the integrity of futures markets and protecting participants against abusive and fraudulent trade practices. A fee on transactions overseen by the CFTC could cover the agency's costs of operation. Such a fee would be similar to one now imposed on securities exchanges to cover the cost of the Securities and Exchange Commission (SEC).

The Administration's budget for 1994 proposed a transactions fee, set at 14 cents per "round turn transaction." Although this idea was dropped from the 1995 budget proposal, such a fee, if imposed in 1996, could generate revenues of $442 million over the 1996-2000 period, which should be sufficient to cover the CFTC's operating expenses during that period. As proposed, the legislation to establish the fee would require the exchanges to remit it four times a year, based on trading volume during the previous quarter. The CFTC would collect the fee and deposit it as an offsetting receipt to the general fund of the Treasury. A similar fee, set at 10 cents per round turn transaction, has been proposed in the Administration's 1996 budget.

The main arguments in favor of the fee are based on the principle that users of government services should pay for those services. Participants in transactions that the CFTC regulates are seen as the primary beneficiaries of the agency's operations and therefore users who should pay a fee. Furthermore, the principle of charging such a fee has already been established by the SEC. Considerations of equity and fairness suggest that not charging a comparable fee to support CFTC operations could give futures traders an unfair advantage over securities traders.

Those who argue against the fee say that such charges tend to generate evasion on the part of people who would be subject to them. Users might try to avoid fees by limiting or shifting transactions to activities that are exempt from charges, which could conceivably cause market participants to desert U.S. exchanges for foreign ones. The effect of such actions could substantially lower the revenue from the fee and, of more concern, lower the benefits that futures transactions provide to the economy.

ENT-19 ELIMINATE THE FLOOD INSURANCE SUBSIDY ON PRE-FIRM STRUCTURES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	361	378	396	414	433	1,982

The National Flood Insurance Program (NFIP) offers insurance at heavily subsidized rates for buildings constructed before January 1, 1975, or the completion of a participating community's "Flood Insurance Rate Map" (FIRM). Owners of post-FIRM construction pay actuarial rates for their insurance. Currently, 18 percent of total flood insurance coverage is subsidized. If all of the subsidized policyholders maintained their coverage at the higher rates, eliminating the subsidy would produce five-year receipts on the order of $2.6 billion. Because many policyholders would be likely to drop their coverage under this option, however, the Congressional Budget Office (CBO) estimates that new receipts would total about $2 billion over the next five years.

The Federal Emergency Management Agency (FEMA), which administers the flood insurance program, reported in 1994 that 41 percent of policyholders were paying subsidized rates for some or all of their coverage. The program subsidizes only the first $45,000 of coverage for a single-family or two- to four-family dwelling, and the first $130,000 of a larger residential, nonresidential, or small business building; various levels of additional coverage are available at actuarially neutral rates. Coverage in the subsidized tier is currently priced at about one-third of its actuarial value. The program also offers insurance for building contents; again, policyholders in pre-FIRM buildings pay subsidized prices for a first tier of coverage.

Some subsidized NFIP policyholders purchased their coverage voluntarily, but others did so because of a statutory requirement prohibiting federally insured mortgage lenders from making loans on uninsured properties in "special flood hazard" areas. Despite the subsidies and mandatory purchase requirement, participation remains low. The report of the Interagency Floodplain Management Review Committee estimated that only 20 percent of structures in the nine states of the 1993 Midwest floodplain carried insurance, reflecting both low rates of purchase for properties not subject to the mandatory requirement (which include an estimated one-half of owner-occupied homes) and the apparent unwillingness or inability of many lenders to enforce the mandatory requirement. The Congress included measures to increase compliance with the mandatory requirement and otherwise boost NFIP participation in the National Flood Insurance Reform Act of 1994. These provisions can be expected to reduce the percentage of current policyholders who would drop their coverage if the subsidies were eliminated, but CBO estimates that about 25 percent would do so nonetheless.

Proponents of eliminating the subsidy argue that actuarially correct prices would make all property owners in flood-prone areas pay their fair share for insurance protection, and would give them the economic incentives to relocate or take preventive measures.

One counterargument asserts that the subsidy should be maintained as part of an effort to increase the low rates of participation by property owners who are not subject to the mandatory purchase requirement. A second argument is that people who built or purchased property before FIRM documented the extent of the flood hazards should not face the same costs as those who made decisions after such information became available. Defenders of the current rates also question the accuracy of FEMA's actuarial tables; although the prices cover only one-third of estimated average costs over the long run, based on FEMA's mapping exercises, they represent 92 per-

cent of average losses incurred in the program. Finally, defenders argue that some of the projected benefit to the Treasury will be offset by increased spending by FEMA and the Small Business Administration on disaster grants and loans to people who drop or fail to purchase insurance coverage at the higher rates.

ENT-20 BROADEN AND EXTEND THE FCC'S AUTHORITY TO USE AUCTIONS TO ASSIGN LICENSES TO USE THE RADIO SPECTRUM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	0	600	2,300	2,700	2,800	8,400

The Omnibus Budget Reconciliation Act of 1993 granted the Federal Communications Commission (FCC) authority to auction new licenses to use the radio spectrum. The authority, however, was limited to a five-year period ending on September 30, 1998, and did not extend to many classes of new licenses. The law excluded licenses issued to profit-making businesses that did not charge a subscription fee for telecommunications services. Most prominent among those excluded were licenses allowing the permit holder to offer broadcast television and radio supported by advertising. Also exempted were licenses permitting the holders to use the spectrum for such private networks as intracorporate wireless communications systems. Exemptions also included permits for intermediary links in the delivery of communications service, such as frequencies used for microwave relays by long-distance telephone companies. In addition, the law did not explicitly permit the FCC to auction other valuable rights that it allocates, specifically, telephone dial codes and commercially attractive call letters for radio and television stations.

Extending the FCC's authority to auction licenses beyond 1998 and broadening the commission's auction authority to include any license sought by a private business would increase receipts by $8.4 billion from 1996 through 2000. Under this option, however, the commission would continue to award licenses to private businesses by comparative hearing when there were not mutually exclusive applications for a band of frequencies. The estimate of five-year receipts includes those that might be gained by auctioning licenses for advanced television (ATV). The FCC has conducted four successful auctions raising more than $7 billion since it was granted the authority to auction licenses. Just how much this option would add to current-law receipts, however, is uncertain. Both telecommunications markets and technologies are changing rapidly and at times unpredictably. The market for licenses used for a variety of private purposes is untested. Moreover, the technical attributes and regulatory limitations carried by the licenses will not be known until the commission allocates frequencies for specific uses. That is particularly true in the case of advanced television, for which digital technology permits an array of options for picture and sound quality. The commission's future actions will have a significant effect on the value of those licenses. The most important decisions will be those that set the technical standard for ATV and determine whether the license holders will be permitted to provide services other than television with the frequencies covered by the license.

The case for extending and broadening the FCC's authority to auction the spectrum and to sell other valuable rights under its regulatory umbrella begins with recognition that the commission has successfully used the auction authority granted to it by current law. The process has gone smoothly, the public is receiving a share of the economic value of the airwaves, and licenses are being awarded promptly to the parties that value them most. Critics of the initial auction statute predicted a very different outcome. More important, advocates of broadening the FCC's auction authority argue that current law draws a false distinction in treating the frequencies used to produce one private good or service in another way than those used to produce a different private good or service. From this point of view the radio spectrum is a scarce resource. The cost to society of using frequencies in one way translates as benefits that might have been gained by using them in another way. That cost is not changed by the fact that a private network or

intermediary use is once-removed from the ultimate consumer of a good or service, or that subscribers do not pay directly for broadcast television. The market provided by an auction is a reasonable way not only to discover which users most value licenses for a specific use, but also to reveal whether the spectrum is being allocated to the most highly valued use from society's point of view. The case for auctioning other valuable rights allocated by the commission is essentially the same as the most basic arguments for auctioning spectrum licenses, namely, that auctions will assure a prompt, fair, and relatively inexpensive assignment of the right in question to the party who values it most.

The case against the option emphasizes a go-slow approach. Early auctions have been successful. Provisions of the law that allow the commission to encourage small businesses and those that are owned by minorities and women have been challenged. Critics might argue that broadening the law to include private networks and intermediary links will increase the cost to businesses seeking to innovate in these areas, thus discouraging the development of new telecommunications technologies and applications. Some people who argue against auctioning ATV licenses hold that the right to use the spectrum carries with it public responsibilities--for example, the equal access rules and those governing the prices charged for political advertising--that impose a cost on the license holder. The contention that broadcasters should receive license rights in exchange for meeting a public interest standard is not, however, recognized in the law. Moreover, all licenses to use the spectrum carry with them a public interest obligation regardless of how they are granted. Participants in an auction will bid less if they decide this obligation imposes a cost on them.

A more specific objection to auctioning ATV licenses holds that the move from the old standard to a new one is merely a channel upgrade and should be seen as a continuance of current license rights (for which many license holders have paid substantial amounts of money in purchasing television stations from their original owners) rather than a new license. In addition, advocates of the current plan hold that it represents a unique approach to the problems of freeing up the spectrum that is allocated to broadcasting under the prevailing standards, rapidly providing consumers with the benefits of improved television and smoothing the transition from old television sets to new ones for both producers and consumers.

The option considered is only one that would increase receipts collected by the FCC above the level anticipated under current law. Alternatively, the Congress could impose an annual fee on the holders of licenses who did not obtain them at auction, or auction all of those licenses not originally assigned by auction at the time of their renewal. Other extensions of the FCC's authority to auction that are not included in this option are those allowing license holders to pay for the right to use their spectrum assignments more flexibly, and allowing the commission to auction off blocks of spectrum without specifying a use.

ENT-21 ESTABLISH CHARGES FOR AIRPORT TAKEOFF AND LANDING SLOTS

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	500	500	500	500	500	2,500

The Federal Aviation Administration (FAA) has established capacity controls at four airports: Kennedy International and La Guardia in New York; O'Hare International in Chicago; and Washington National in the District of Columbia. This proposal would charge annual fees for takeoff and landing rights at those airports.

Takeoff and landing slots were instituted in 1968 to control capacity and were allocated without charge by the FAA. A total of about 3,400 air carrier slots exist, with an additional 1,400 commuter and general aviation slots at the four FAA-controlled airports. Airlines are currently allowed to buy and sell slots among themselves, with the understanding that the FAA retains ultimate control and can withdraw the slots or otherwise change the rules on their use at any time. These slots have value because the demand for flights at times exceeds the capacity of the airports and the air traffic control system.

Estimating the revenue from slot charges is difficult. Airlines generally have not reported the prices they have paid for slots, and even when the value of a transaction is available, the slot value is unclear because slot sales often include other items of value, such as gates. In addition, slot values vary by airport, time of day, season, and other factors. Because the FAA reserves the right to withdraw and add slots and change the rules affecting their use, airlines that buy slots from other carriers must factor in uncertainty when deciding how much a slot is worth. The amount of revenue that could be obtained from annual charges would depend on similar factors, including the length of the lease. For these reasons, the Congressional Budget Office's estimates are somewhat equivocal. Revenues are estimated to be about $500 million annually and $2.5 billion over the 1996-2000 period. But they could be higher or lower depending on the structure of the leasing arrangements --such as length, whether slots could be subleased, and usage requirements--as well as market conditions affecting the airline industry.

The main argument in favor of establishing charges for slots is that since the slots reflect the right to use scarce public airspace, airports, and air traffic control capacity, private firms and individuals should not receive all the benefits that result from this scarcity. Instead, they should share it with the public owners of the rights. Further, the charges would serve as incentives to put these scarce resources to their best use.

The main argument against this proposal is that the scarcity of slots at the four airports arises principally from a lack of land and runway space; the fees are not intended to provide increased capacity. Further, if the current prices paid by airlines in the private sale of slots already accurately reflect their value, this proposal might not produce a better allocation of these scarce resources; the result would be only a redistribution of the benefits from their use between the private and public sectors.

ENT-22 ESTABLISH USER FEES FOR AIR TRAFFIC CONTROL SERVICES

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	725	1,500	1,550	1,650	1,750	7,175

The Federal Aviation Administration (FAA) manages the air traffic control (ATC) system, which serves commercial air carriers, military planes, and such smaller users as air taxis and private planes. Services provided include air traffic control towers that assist planes in takeoffs and landings, air route traffic control centers that guide planes through the nation's airspace, and flight service stations that assist smaller users. The FAA has more than 17,000 air traffic controllers as well as sophisticated software to perform these tasks. The total cost of operating, maintaining, and upgrading the ATC system was about $6.2 billion in 1994.

Currently, one-half of FAA operations are financed through annual appropriations from the general fund, whereas revenues from aviation excise taxes are used for a variety of purposes, such as facilities and equipment, research, engineering and development, and such non-ATC activities as airport improvement.

Over the past year, several proposals have been advanced for reorganizing the FAA and spinning off its air traffic control functions to a private or quasi-public corporation. Such an entity would have to charge users for its services. If air traffic control remains within the FAA, the FAA could impose user fees to cover a larger portion of ATC costs than the excise taxes cover.

If users paid the marginal costs that the ATC system incurs on their behalf, the deficit would be reduced by about $725 million in 1996 and $7.2 billion over the 1996-2000 period. This assumes that the new charges would be levied in the middle of fiscal year 1996.

Users would be charged according to the number of facilities they used on a flight and the marginal costs of their use at each facility. The various classes of users would be affected differently. Smaller users, such as general aviation users, would experience comparatively greater increases in the cost of flying than larger users, such as commercial airlines.

Levying efficient fees presumably would oblige users to moderate their demands. Small users who are required to pay these costs would cut back on their consumption of ATC services, freeing controllers for other tasks and increasing the overall capacity of the system. An additional benefit of efficient fees is that, on the basis of user response, planners can judge how much new capacity is needed and where it should be located.

The main argument against this option is that it would raise the cost of ATC services. For commercial air carriers, this could contribute to their already difficult financial circumstances. For general aviation, it also could cause a decline in the demand for small aircraft produced in the United States.

ENT-23 IMPOSE USER FEES ON THE INLAND WATERWAY SYSTEM

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	337	493	524	543	563	2,460

The Congressional Budget Office estimates that the Congress annually appropriates about $500 million for the nation's system of inland waterways. Of that total, about $230 million is for operation and maintenance (O&M) and about $260 million is for construction. Current law allows up to 50 percent of inland waterway construction to be funded by revenues from the inland waterway fuel tax, a levy on the fuel consumed by barges using most segments of the inland waterway system. Revenues from the tax currently fund about 20 percent of federal outlays for inland waterway construction. All O&M expenditures are paid by general tax revenues.

Imposing user fees high enough to recover fully both O&M and construction outlays for inland waterways would reduce the federal deficit by $337 million in 1996 and $2.5 billion during the 1996-2000 period. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. These estimates do not take into account any resulting reductions in income tax revenues.

The advantage of this option is the beneficial effect of user fees on efficiency. Reducing subsidies to water transportation should improve resource allocation by inducing shippers to choose the most efficient transportation route, rather than the most heavily subsidized one. Moreover, user fees would encourage more efficient use of existing waterways, reducing the need for new construction to alleviate congestion. Finally, user fees send market signals that identify the additional projects likely to provide the greatest net benefits to society.

The effects of user fees on efficiency would depend in large measure on whether the fees were set at the same rate for all waterways or according to the cost of each segment. Since costs vary dramatically among the segments, systemwide fees would offer weaker incentives for cost-effective spending. In 1989, for example, O&M costs on the inland waterways ranged from less than 50 cents per 1,000 ton-miles on the lower Mississippi River (between the Ohio River and Baton Rouge) to about $140 per 1,000 ton-miles on the Allegheny River. A systemwide fee of $1.75 per 1,000 ton-miles would recover all O&M outlays but would do little to ration use of the system. Fees set for specific segments, by contrast, could cause users to abandon some segments of the waterways.

One argument in favor of federal subsidies is that they may promote regional economic development. Assessing user fees would limit this promotional tool. Reducing inland waterway subsidies would also lower the income of barge operators and grain producers in some regions, but these losses would be small in the context of overall regional economies.

ENT-24 INCREASE USER FEES FOR GENERAL AVIATION

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	14	14	14	14	14	70

The Federal Aviation Administration (FAA) estimates that general aviation (private and corporate aircraft) accounts for 26 percent of the FAA's costs but only 2 percent of revenues from users of the aviation system. General aviation cost the system $2.1 billion in 1992 but generated revenues of only $157 million, a cost recovery rate of 7 percent. By contrast, commercial air carriers (or their passengers) pay more in taxes than their share of the costs, according to FAA estimates.

Currently, the FAA charges a $5 aircraft registration fee for general aviation. The fee is assessed only once, unless certain events--such as a change of ownership--trigger a need for reregistration. The current fee brings in about $200,000 annually. A yearly registration fee of $100 would produce receipts of $14 million a year and $70 million over five years; however, collection costs would be about $2 million a year, and the FAA might require additional appropriations to cover those costs. The receipts could be considered tax revenues, offsetting receipts, or offsetting collections, depending on the form of the implementing legislation. These estimates do not take into account any resulting reductions in income tax revenues.

Several arguments could be marshalled against this option. For one, the Drug Enforcement Assistance Act of 1988 authorizes the FAA to impose registration fees of up to $25--as long as they do not raise more in collections than the FAA's cost of administering the registration program. Setting higher fees would require additional legislation. In addition, increasing the registration fee to $100 annually might severely burden some aircraft owners, although that effect could be mitigated by scaling registration fees according to the size or value of the aircraft. In comparison with registration fees for automobiles in most states, however, a $100 fee to register an aircraft is not out of line.

But even if the FAA raised its registration fee to $100, the agency estimates that general aviation still would not be paying its share of costs. In order to narrow the gap, additional charges or taxes that varied with the amount of use of the FAA's services could also be imposed.

ENT-25 REDUCE SUBSIDIES FOR STUDENT LOANS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
	Raise the Loan Origination Fee					
Outlays	275	405	420	430	450	1,980
	Raise Interest Rates After the Six-Month Grace Period					
Outlays	340	530	585	630	665	2,750
	Charge All Borrowers Interest While They Are Attending School					
Outlays	1,620	2,490	2,645	2,770	2,900	12,425
	Charge All Borrowers Interest During the Six-Month Grace Period					
Outlays	330	510	545	575	610	2,570

Federal student loan programs afford postsecondary students and their parents the opportunity to borrow funds to attend school. The Higher Education Amendments of 1992 created a "subsidized" program for students defined as having financial need and an "unsubsidized" program for students from families with greater financial resources and for parents of students. In the subsidized program, the federal government incurs interest costs on the loans while the students are in school and during a six-month grace period after they leave. In the unsubsidized program, borrowers are responsible for the interest costs, although for students, payments can be made after they leave school. The government recoups part of the cost of these programs by collecting between 3 percent and 4 percent of the face value of each loan as an origination fee.

Borrowers benefit from both the subsidized and unsubsidized programs because the interest rate they are charged is tied to the cost of borrowing by the federal government. Although the government provides no budgeted subsidy in allowing borrowers access to funds at this low rate, the rate is considerably lower than that most borrowers would be charged in the private credit market. Nonetheless, the economic subsidy is larger in the "subsidized" program because interest is not charged until six months after the students leave school, whereas it begins to accrue immediately in the "unsubsidized" programs.

Federal costs could be reduced by increasing the loan origination fee charged to borrowers or by increasing the interest charged to borrowers on new loans. Interest charges could be raised by increasing the interest rate charged after students leave school, or by requiring all borrowers to accrue interest while students are in school or in the six-month grace period after they leave.

Raise the Loan Origination Fee to 5 Percent. Raising the loan origination fee to 5 percent (the level before the Omnibus Budget Reconciliation Act of 1993) would reduce federal subsidies by a total of $2 billion during the next five years. It would, however, give lower subsidies to all borrowers, including those with the fewest financial resources. An alternative, which would exempt many lower-income borrowers, would be to raise the fee only in the unsubsidized program. That version would, however, limit the savings to $820 million over the 1996-2000 period.

Raise Interest Rates After the Six-Month Grace Period. Federal subsidies could also be reduced by raising the interest rate and interest rate cap on all new variable-rate loans by 0.5 percentage points after the six-month grace period. For guaranteed loans, lenders would remit a fee to the federal government for these payments. This option would reduce federal spending by $2.7 billion during the 1996-2000 period.

An advantage of this option is that it would raise the cost of the program to borrowers after they left school, when they could better afford it. It would also lower federal costs significantly and continue to provide economic subsidies to borrowers in the subsidized program. The larger payments that would result from this change might, however, cause some students (especially needy students) to limit their choices to lower-priced institutions or possibly not to attend school. (Reflecting the available evidence, however, these estimates assume that all borrowers would continue to attend postsecondary schools and would continue to borrow the same amounts).

As with raising the loan origination fee, this option could be applied only to borrowers in the unsubsidized loan program. Doing so would generally limit the effect of the change to students from families with greater financial resources and to parents, but it would also lower the savings to $1.2 billion between 1996 and 2000.

Charge All Borrowers Interest While They Are Attending School or During the Six-Month Grace Period. Another option would be to require all borrowers in the subsidized program to accrue interest from the time they borrow, as is now the case in the unsubsidized program. In effect, doing so would eliminate the difference between subsidized and unsubsidized loans. Charging interest on all new loans while borrowers were in school, but deferring actual payments until after they left, would reduce federal outlays by $12.4 billion between 1996 and 2000.

A variation of this option that would reduce but not eliminate the subsidy given to lower-income borrowers would require all borrowers to begin accruing interest on their loans immediately after leaving school, thereby eliminating the current six-month grace period for subsidized borrowers. Under this option, borrowers would continue to be allowed a period of six months before the first payment was due. That approach would save about $2.6 billion over the 1996-2000 period.

These measures would not cause cash flow problems for students while they were in school because they would be allowed to defer interest payments during that period. Since the added costs would generally occur only after leaving school--when borrowers would be better able to afford them--most students would still be able to continue their education. By concentrating the reductions on the subsidized loan program, however, these options would have the greatest impact on lower-income borrowers.

ENT-26 REDUCE STAFFORD LOAN SPENDING BY INCLUDING HOME EQUITY IN THE DETERMINATION OF FINANCIAL NEED AND MODIFYING THE SIMPLIFIED NEEDS TEST

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Outlays	90	130	130	130	130	610

The Higher Education Act of 1992 eliminated house and farm assets from consideration in determining a family's ability to pay for postsecondary education, thereby making it easier for many students to obtain Stafford loans. The Higher Education Act specifies formulas to calculate a family's need for Stafford loans. The amount a family is expected to contribute is determined by what is essentially a progressive tax formula. In effect, need analysis "taxes" family incomes and assets above amounts assumed to be required for a basic standard of living. The definition of assets excludes house and farm equity for all families, and all assets for applicants with income below $50,000.

Under this option, house and farm equity would be included in the calculation of a family's need for financial aid for postsecondary education. In addition, the threshold under which most families are not asked to report their assets would also be lowered to its previous level of $15,000. House and farm equity would be "taxed" at rates up to roughly 5.6 percent after a deduction for allowable assets.

Outlays could be reduced by about $610 million during the 1996-2000 period by including house and farm equity and modifying the simplified needs test. There could also be associated savings in the Pell Grant program, a discretionary program that provides grants to low-income students. Outlays in that program could be reduced from the 1995 funding level adjusted for inflation by about $25 million in 1996.

Families whose house appreciated during the 1980s are now financially better off than they would have been if they had not owned a house then. Moreover, not counting this equity gives families who own a house an advantage over those who do not. There is concern, however, that because increases in incomes have not always kept pace with increases in housing prices, some families might have difficulty repaying their mortgage if they borrow against the equity in their house to finance their children's education. In addition, having to value their home and other assets would complicate the application process for many families.

ENT-27 INCREASE USER FEES ON PRODUCTS REGULATED BY THE FDA

	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Receipts	86	93	97	101	105	482

Increasing the level of fees charged by the Food and Drug Administration (FDA) for new drug applications and establishing user fees for other products regulated by the FDA could increase revenues by $86 million in 1996 and by $482 million for 1996 through 2000. The Administration's 1995 budget proposed new FDA user fees that would have raised $252 million in the first year, but those new fees were not levied. This option proposes various fees and fee increases that would raise about a third of the Administration's proposed revenue level.

The FDA's regulatory activities are beneficial to both the consumer and industry. The primary function of the FDA is to ensure public safety by monitoring the quality of pharmaceutical products, medical devices, and food. Firms benefit from the public confidence that results from FDA's quality standards. Ensuring a high level of product quality is essential to the success of these industries. Proponents of establishing new user fees argue that since firms benefit from these regulatory services, they should bear a share of the costs.

The Prescription Drug User Fee Act of 1992 established application fees and set a projected revenue schedule. The FDA charges a fee of $208,000 for each new drug application. The fee is $104,000 for each generic drug and supplemental application. In addition, pharmaceutical firms that have had a new drug application pending with the FDA at any time since September 1992 must pay an annual fee of $126,000 per manufacturing establishment and $12,500 per product on the market. In 1995, those fees are scheduled to raise $75 million, covering about 20 percent of the FDA's expenditures on regulating prescription drugs. The fees will increase slightly through 1997, when they are scheduled to raise $94 million. A 40 percent increase in the fee schedule above that specified by law would produce an additional $35 million in revenues in 1996 and $193 million between 1996 and 2000.

The Food, Drug, and Cosmetic Act requires that firms register all new medical devices before they are marketed and obtain FDA approval for certain types of new medical devices (class III). Currently, manufacturers of medical devices do not pay fees to the FDA. Recent legislation proposed submission fees for the approval and registration of new medical devices that would have raised $24 million, but it did not pass the Congress. Fees of $60,000 for the application of each new medical device would raise $4 million in 1996. Fees of $6,000 for new product registration would raise $24 million in 1996. Combined, those fees would cover about 20 percent of the costs of regulating the medical device industry. If the new fees were used to increase FDA expenditures, they would not reduce the deficit. Industry would be likely to agree to new application fees and fee increases if the raises were accompanied by promises to speed up the approval process, but that could increase FDA expenditures.

Finally, the food industry could be charged user fees that would raise $22 million in 1996, covering about 10 percent of the FDA's costs of regulating the industry. The FDA inspects domestic food processors, analyzes more than 17,000 domestic food samples a year, and monitors the quality of seafood. If the FDA charged domestic food processors employing more than 250 people and processing all foods except meat and poultry an annual fee of $10,000, it could raise $12 million. If the Food and Drug Administration also charged each domestic establishment employing 100 to 249 people an annual fee of $5,000, it could raise another $10 million.

Higher user fees for the entire food industry would be cumbersome. There are more than 15,000 domestic food processors who employ fewer than 100 people. Smaller establishments have a much lower sales volume and therefore must be charged a much lower annual fee. Collecting a low fee from so many establishments, however, might be counterproductive. And charging higher fees than those proposed for the larger establishments could hamper the ability of those large firms to compete with smaller establishments that would pay no fees.

In general, people opposing FDA user fees might argue that the FDA's current regulations are excessive. Rather than increasing user fees, the FDA could cut costs by scaling back its regulatory activities.

ENT-28 LIMIT THE GROWTH OF FOSTER CARE ADMINISTRATIVE COSTS TO 10 PERCENT A YEAR

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	110	220	210	220	220	980
Outlays	90	200	210	220	220	940

The Federal Foster Care program, authorized under title IV-E of the Social Security Act, is an open-ended entitlement program that provides federal matching funds to assist states in providing foster care to children who meet certain eligibility requirements. In 1996, the program is expected to serve an average of about 280,000 children a month at a federal cost of $3.5 billion. Administration of the program will account for about 45 percent of that total. Each state administers its own program within the federal mandates established in title IV. The federal government reimburses states for one-half of certain administrative costs, including those for determining eligibility, certain preplacement services, and child placement, as well as for administrative overhead.

Policymakers have been concerned about the rapidly escalating costs for administering this program. Those costs increased from $50 million (in 1993 dollars) in 1981 to $1.1 billion in 1993. This option would limit annual increases in payments to each state for administrative costs to 10 percent a year, reducing federal outlays by $940 million in the 1996-2000 period.

This option would exclude the expense of installing new computer systems, which are eligible for 75 percent federal funding through September 30, 1996. The process is already under way. In order to calculate the savings, installation expenses were not included in the base used to calculate the allowable increases in administrative expenses, nor were they included in subsequent administrative expenses.

During the 1980s, costs increased much more rapidly than caseloads. At some point in the past decade, many states' administrative costs increased sharply. In about one-half of the states, the annual increase in such costs per child exceeded 1,000 percent in at least one year, supporting the theory that much of the growth resulted from changes in states' methods for claiming funds rather than from expanded services to children.

It might not be advisable, however, to slow the growth in federal funding to child welfare agencies when these groups are struggling to deal with reported increases in child abuse and neglect. If states responded to the restriction by cutting back services, children in need of foster care could be harmed. Limiting the percentage increase that each state could receive would also lock in the current differences in costs per child. In 1993, estimates of average federal costs per child for title IV-E administration ranged from less than $150 a month in five states to more than $600 a month in four states.

ENT-29 REDUCE THE 50 PERCENT FLOOR ON THE FEDERAL SHARE OF MEDICAID, AFDC, FOSTER CARE, AND ADOPTION ASSISTANCE PAYMENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Medicaid Outlays	4,600	5,090	5,650	6,240	6,860	28,440
AFDC Outlays	560	570	580	590	610	2,910
Foster Care/Adoption Assistance Outlays	240	310	350	390	420	1,710
Offsets in the Food Stamp Program	-110	-110	-110	-110	-110	-550
Total	5,290	5,860	6,470	7,110	7,780	32,510

The Medicaid program provides medical assistance to current or recent beneficiaries of the Aid to Families with Dependent Children (AFDC) program, low-income people who receive Supplemental Security Income, and certain other low-income individuals. The AFDC program provides cash assistance to low-income families in which one parent is absent or incapacitated or in which the primary earner is unemployed. The Foster Care and Adoption Assistance programs provide benefits and services to children who are in need.

The federal government and the states jointly pay for the Medicaid, AFDC, and Foster Care and Adoption Assistance programs. The federal share of the costs of these programs varies with a state's per capita income. High-income states pay for a larger share of benefits than low-income states. By law, the federal share can be no less than 50 percent and no more than 83 percent. The 50 percent federal floor currently applies to 12 jurisdictions: Alaska, California, Connecticut, the District of Columbia, Hawaii, Illinois, Maryland, Massachusetts, Nevada, New Hampshire, New Jersey, and New York.

Under this option, the 50 percent floor would be reduced to 45 percent, generating savings of about $5.3 billion in 1996 and $32.5 billion through 2000. Federal savings for the Medicaid program would be $4.6 billion in 1996 and $28.4 billion over the 1996-2000 period; outlays for AFDC would be reduced by $560 million in 1996 and $2.9 billion over the five-year period; and outlays for Foster Care and Adoption Assistance would decline by $240 million in 1996 and $1.7 billion over the five-year period. The estimates assume, however, that states would partially offset their higher costs by reducing benefits. Lowering AFDC payments would make some families eligible for larger Food Stamp benefits. Under this assumption, then, outlays for the Food Stamp program would increase by $110 million in 1996 and $550 million over the five-year period.

Proponents of this change argue that high-income states that choose to be generous should bear a larger share of the cost. If the floor was reduced to 45 percent, federal contribution levels would be more directly related to the state's income, and eight of the 12 jurisdictions would still be paying less than the formula alone would require. In January 1994, 11 of the 12 jurisdictions that would be affected by this proposal paid AFDC benefits that were at or above the median when states were ranked by size of benefits (for a three-person family). The higher benefit levels in these states mean that more families are eligible for AFDC and thus for Medicaid.

Opponents of the change stress that the higher incomes and benefit levels in the affected states partly reflect higher costs of living. If this proposal was adopted, the affected states would have to compensate for the lost federal grants by reducing Medicaid, AFDC, and Foster Care and Adoption Assistance benefits, lowering spending on other services, or raising taxes. If states chose to compensate by partially reducing benefits, as the estimates assume, program beneficiaries would be adversely affected.

ENT-30 REDUCE MATCHING RATES FOR ADMINISTRATIVE COSTS IN THE MEDICAID, FOSTER CARE, AND ADOPTION ASSISTANCE PROGRAMS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
	Reduce Matching Rates to 50 Percent					
Budget Authority	605	685	760	835	920	3,805
Outlays	605	685	760	835	920	3,805
	Reduce Matching Rates to 45 Percent					
Budget Authority	1,180	1,340	1,470	1,620	1,770	7,380
Outlays	1,180	1,340	1,470	1,620	1,770	7,380

The Medicaid program provides medical assistance to low-income people who are recipients of Supplemental Security Income and to current or recent recipients of Aid to Families with Dependent Children, as well as certain other low-income individuals. The Foster Care and Adoption Assistance programs provide benefits and services to children in need.

In all of these programs, the federal government pays half of most administrative costs; state and local governments pay the remaining share. Higher matching rates have been set for some types of expenses as an inducement for local administrators to undertake more of a particular administrative activity than they would if such expenses were matched at 50 percent. For example, in Medicaid, enhanced matching rates are applied to the costs of automating claims processing, reviewing medical and health care use, and establishing and operating fraud control units. In Foster Care and Adoption Assistance, training costs are matched at 75 percent.

Reducing the higher matching rates to 50 percent would decrease federal outlays by $0.6 billion in 1996 and by $3.8 billion over the 1996-2000 period. Medicaid would account for virtually all of the reduction; outlays would decline by only $0.4 billion over the period for Foster Care and Adoption Assistance. Considerably greater savings would be generated if all the matching rates for administrative costs were reduced to 45 percent, because an additional 5 percent of the total administrative expenses would be shifted to the states. Federal outlays would fall by $1.2 billion in 1996 and by $7.4 billion over the 1996-2000 period. Medicaid would account for $6 billion of the total over the five years.

Reducing the higher matching rates to 50 percent would be appropriate if the need to provide special incentives for these activities no longer exists. For example, all state Medicaid programs have already established computer systems and are currently operating units to control fraud and abuse. Reducing all matching rates to 45 percent would provide states with stronger incentives to reduce administrative inefficiencies, because the states would be liable for a greater share of the cost of such inefficiencies.

States might respond to either option by reducing their administrative efforts, however, and might thereby raise program costs and offset some of the federal savings. Specifically, states might make less effort to eliminate waste and abuse in payments to providers. In addition, this proposal might harm recipients by encouraging states to lower benefits or to limit services provided under these programs in order to constrain total costs.

ENT-31 RESTRICT THE INCOME CRITERIA THAT STATES MAY USE TO ESTABLISH MEDICAID ELIGIBILITY FOR CHILDREN AND PREGNANT WOMEN

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	600	800	1,000	1,300	1,600	5,200
Outlays	600	800	1,000	1,300	1,600	5,200

In recent years, the Congress has expanded Medicaid to provide coverage for low-income children and pregnant women who would not otherwise qualify for the program. States are now required to cover children under 6 years old and pregnant women in families with income up to 133 percent of the poverty level, plus children under age 19 born after September 30, 1983, whose families have income below the poverty level. States have the option to cover infants under one year of age and pregnant women in families with income up to 185 percent of the poverty level, and the majority of states do so. They may also cover older children under a state-selected age (21, 20, 19, or 18 years) who meet the income and resource requirements for Aid to Families with Dependent Children (AFDC).

When determining the income and resource criteria to be used in establishing Medicaid eligibility for children and pregnant women, some states have taken advantage of provisions included in section 1902(r)(2) of the Social Security Act in order to expand coverage. The provisions state that for these and certain other population groups, states "may be less restrictive and shall be no more restrictive" than when they determine eligibility for similar population groups that receive categorical welfare benefits such as AFDC. That language has enabled states to disregard larger amounts of income when establishing Medicaid eligibility for children and pregnant women than can be disregarded when establishing eligibility for AFDC. Consequently, some states have been able to expand coverage to children and pregnant women whose income is considerably higher than the levels nominally permitted by legislation. By July 1994, 12 states were obtaining federal matching funds for such expansions, and more are likely to do so in the future; some states applying for statewide Medicaid demonstration waivers under section 1115 of the Social Security Act are incorporating expansions of eligibility under section 1902(r)(2) into their waiver applications.

This option would require the states to use the AFDC program's criteria to determine countable income when establishing the eligibility of children and pregnant women for Medicaid. The income eligibility criteria used by the states would then reflect more closely the maximum levels of income specified in recent legislation. The requirement would, however, restrict states' initiatives to expand health insurance coverage to other low-income people. Since the option would include the states that have already expanded eligibility using a plan amendment under section 1902(r)(2), it could cause some people in those states to lose their health care coverage.

The anticipated savings would be $600 million in 1996 and $5.2 billion over the 1996-2000 period. These estimates are highly tentative, however, because the number of states that will seek, obtain, and put into effect section 1115 waivers that incorporate expansions of eligibility under section 1902(r)(2) is uncertain. The timing of any such waivers and the extent of any eligibility expansions are also uncertain. An alternative option would restrict future plan amendments under section 1902(r)(2) but allow existing ones to continue. Savings from that approach would be less.

ENT-32 MAKE CAPITATION PAYMENTS TO THE STATES FOR MEDICAID SERVICES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	1,000	1,900	3,200	4,700	6,700	17,500
Outlays	1,000	1,900	3,200	4,700	6,700	17,500

The Medicaid program is administered by the states and jointly funded by the federal and state governments. Each state designs its own program subject to federal requirements and guidelines, but the federal government has an open-ended financial commitment to match each state's expenditures for the coverage of eligible people. Federal matching rates for medical services are higher for states that have lower per capita incomes but can never be less than 50 percent or more than 83 percent of medical assistance payments. The federal government also pays 50 percent of most associated administrative costs (with higher rates for a few services).

This proposal would replace the current federal financing mechanism for acute care services with a system under which the federal government would make fixed payments to the states for each person enrolled in their Medicaid programs. (The only exception would be federal payments on behalf of people who are jointly eligible for Medicare and Medicaid. Those payments would continue in their current form.) At the same time, states would be given greater flexibility to tailor their Medicaid programs to meet the needs of their populations without having to seek waivers of federal legislation and regulations to do so. The federal capitation payments would vary according to broad categories of eligibility, with differing amounts for beneficiaries of Supplemental Security Income, other adults, and other children. Payments to each state would be based on its per capita spending in 1995 for all Medicaid services except long-term care (but would exclude payments to disproportionate share hospitals). The 1995 per capita amounts would be indexed by the rate of growth of gross domestic product per capita. The anticipated savings would be $1 billion in 1996 and $17.5 billion over the 1996-2000 period.

The proposed financing structure would provide states with both the incentives and the flexibility to limit Medicaid spending and seek cost-effective managed care providers for their Medicaid beneficiaries. Medicaid expenditures would become much more predictable for the federal government and would grow no faster than the rest of the economy on a per capita basis. The proposal would, however, lock in the existing differences in the generosity of states' programs and in their reimbursement rates. Moreover, federal per capita payments for Medicaid would grow much more slowly than overall per capita health expenditures. States might have to increase their relative contributions to the program in order to ensure that providers would continue to serve Medicaid's beneficiaries. Concerns might also arise about the quality of care received by Medicaid beneficiaries if they were enrolled in managed care plans at rates significantly lower than those prevailing in the private sector.

ENT-33 FREEZE MEDICARE'S PROSPECTIVE PAYMENT SYSTEM RATES FOR ONE YEAR

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Outlays	950	1,280	1,360	1,450	1,550	6,590

Under Medicare's prospective payment system (PPS), payments for the operating costs of inpatient hospital services provided to beneficiaries are determined on a per-case basis, according to preset rates that vary with the patient's diagnosis and characteristics of the hospital. For 1988 through 1994, separate rates applied to hospitals in three types of location: urban areas with a population of more than 1 million, other urban areas, and rural areas. Beginning with 1995, hospitals in rural and "other urban" areas receive the same payment rates. The annual amount of increase in the payment rates, called the update factor, is usually based on the increase in an index of hospitals' costs known as the hospital market-basket index.

For 1996, under the Omnibus Budget Reconciliation Act of 1993, the update factor for all PPS hospitals will equal the percentage increase in the market-basket index minus 2 percentage points. Based on the Congressional Budget Office's current estimate of 3.8 percent growth in the market-basket index, the update factor will be 1.8 percent for 1996.

Under this option, Medicare would freeze PPS hospital rates for 1996 at their 1995 levels by setting the update factor to zero, thereby saving nearly $1 billion in 1996 and $6.6 billion over the 1996-2000 period. In response to the freeze, some hospitals could increase their efficiency, absorb the reductions through lower profits, or increase their revenues from other sources. It might be difficult, however, for others to adjust to the cuts. For example, the Prospective Payment Assessment Commission estimates that in 1992 approximately one-fourth of hospitals had greater total costs than revenues. As a result, some Medicare beneficiaries might have less access to hospital and other services or lower quality care. In addition, some facilities might cut back on the amount of uncompensated care they provide to patients who are uninsured and unable to pay for it.

ENT-34 ELIMINATE THE DISPROPORTIONATE SHARE ADJUSTMENT FOR HOSPITALS IN MEDICARE'S PROSPECTIVE PAYMENT SYSTEM

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Immediately Eliminate the Disproportionate Share Adjustment						
Outlays	3,660	4,360	4,560	4,820	5,040	22,440
Gradually Eliminate the Disproportionate Share Adjustment						
Outlays	730	1,630	2,620	3,730	4,690	13,420

Under Medicare's prospective payment system (PPS), higher rates are paid to hospitals with a disproportionately large share of low-income patients. In 1985, the Congress added this "disproportionate share" adjustment to account for the presumed higher costs of treating Medicare beneficiaries at these hospitals. One rationale for the adjustment is that low-income Medicare patients may be sicker and therefore more expensive to treat than other Medicare patients. Another rationale is that hospitals with large numbers of low-income patients may provide additional staffing, facilities, and services in response to such patients' needs. In 1996, outlays for disproportionate share payments are expected to total $3.7 billion, or more than 5 percent of all PPS payments for operating expenses.

Data on hospitals' costs provide only limited support for any disproportionate share adjustment. Although more than 1,900 hospitals receive disproportionate share payments, the only group for which such an adjustment would be supported by the data is large urban hospitals that have extremely high values of the disproportionate share index. This group is made up of approximately 160 hospitals and accounts for about one-fifth of all disproportionate share payments.

If the disproportionate share adjustment was eliminated immediately, outlays would fall by $22.4 billion over the 1996-2000 period. Phasing out the disproportionate share adjustment by the end of 2000 would reduce outlays by about $13.4 billion over the same five years. Alternatively, the adjustment could be eliminated for all hospitals except large urban institutions with the highest disproportionate share indexes. If the adjustment was restricted to that group and lowered to 5 percent--the level suggested by the data on costs--savings for the five-year period would be about $500 million less under the first option and about $300 million less under the second one.

Without the disproportionate share adjustment, Medicare's payments to all hospitals would be similar in relation to their costs of treating Medicare beneficiaries. Phasing out the adjustment over several years would give affected hospitals time to adjust. Nevertheless, many of those institutions are in poor financial condition, and since 1990, Medicare's PPS payments to hospitals have been less, on average, than the costs of treating patients who are covered. If eliminating the disproportionate share adjustment led some hospitals to cut back on charity care, or if some were forced to close, residents of the areas the hospitals serve could have less access to care.

ENT-35 REDUCE MEDICARE'S PAYMENTS FOR THE INDIRECT COSTS OF PATIENT CARE THAT ARE RELATED TO HOSPITALS' TEACHING PROGRAMS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
			Reduce the Teaching Adjustment to 6 Percent			
Outlays	930	1,120	1,200	1,280	1,360	5,890
			Reduce the Teaching Adjustment to 3 Percent			
Outlays	2,600	3,150	3,350	3,600	3,800	16,500

The Social Security Amendments of 1983 established the prospective payment system (PPS) under which Medicare reimburses hospitals for inpatient services provided to beneficiaries. Higher rates are paid to hospitals with teaching programs to cover their additional costs of caring for Medicare patients. In particular, payments to these hospitals are raised by approximately 7.7 percent for each 0.1 increase in a hospital's ratio of full-time interns and residents to its number of beds. This adjustment was included in order to compensate hospitals for indirect teaching costs--such as the greater number of tests and procedures thought to be prescribed by interns and residents--and to cover higher costs caused by factors that are not otherwise accounted for in setting the PPS rates. These factors include more severely ill patients, location in inner cities, and a more costly mix of staffing and facilities--all of which are associated with large teaching programs.

Estimates based on data from the 1984-1990 period suggest that the teaching adjustment could be lowered to between 2 percent and 7 percent, depending on which year's data are used and which of many possible assumptions are used in forming an assessment. If the teaching adjustment was lowered to 6 percent, outlays would fall by about $5.9 billion from current-law spending over the 1996-2000 period. Alternatively, if the teaching adjustment was lowered to 3 percent, outlays would fall by about $16.5 billion from current-law spending over that period.

This option would better align payments with the actual costs incurred by teaching institutions. Furthermore, since the training that medical residents receive will result in a significant increase in their future income, it is reasonable for some or all of a hospital's indirect training costs to be passed on to residents. Some of these costs are now passed on in the form of stipends that are lower than the value of the residents' services to the hospital. A lower teaching adjustment would probably lead to even lower stipends, as well as smaller residency programs. Although this might be considered a disadvantage to some individuals who are seeking residency positions, several health policy groups, including the Physician Payment Review Commission, believe that a decline in the number of residency positions is desirable. Finally, if these hospitals now use some payments to fund such activities as charity care, low-income people could have less access to care.

ENT-36 REDUCE MEDICARE'S DIRECT PAYMENTS FOR MEDICAL EDUCATION

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Outlays	650	710	760	820	880	3,820

Medicare's prospective payment system does not include payments to hospitals for the direct costs they incur in providing graduate medical education (GME); namely, residents' salaries and fringe benefits, teaching costs, and institutional overhead. Instead, Medicare makes these payments separately, based on Medicare's share of a hospital's 1984 cost per resident indexed for increases in the level of consumer prices. Medicare's GME payments, which are received by about one-fifth of all U.S. hospitals, totaled about $1.8 billion for 1994.

In effect, this option would reduce teaching and overhead payments for residents, but continue to pay their salaries and fringe benefits. Hospitals' GME payments would be based on the national average of salaries paid to residents in 1987, updated annually by the consumer price index for urban areas. Reimbursement would be based on 120 percent of the national average salary. Unlike the current system, under which GME payments vary considerably from hospital to hospital, this option would pay every hospital the same amount for the same type of resident. The option would also continue the current-law practice of reducing payments for all residents who have gone beyond their initial residency period. The savings from current-law spending over the 1996-2000 period would total about $3.8 billion.

The overall reduction in the level of subsidies might be warranted since market incentives appear to be sufficient to encourage a continuing flow of new physicians. Moreover, since hospitals use resident physicians to care for patients and since residency training helps young physicians earn higher incomes in the future, both hospitals and residents might reasonably contribute more to those training costs. Residents would contribute more to those training costs if hospitals responded to the changes in reimbursements by cutting residents' salaries or fringe benefits.

Opponents of reducing Medicare's GME payments point out that some physicians incur substantial debts during their medical education. If hospitals lowered residents' salaries or benefits, the terms of the loan repayment agreements could exert greater influence on these young physicians' decisions about specialty or practice location. For example, a resident who must begin repaying loans after three years of a medical residency might choose to begin primary care practice rather than specialize further. That outcome could be negative for the individual resident; by contrast, the Physician Payment Review Commission and other groups believe that a relative increase in the number of primary care practitioners would be desirable. Finally, decreasing GME reimbursement could force some hospitals to reduce the resources they commit to training, possibly jeopardizing the quality of their medical education programs.

ENT-37 ELIMINATE MEDICARE'S ADDITIONAL PAYMENTS TO SOLE COMMUNITY HOSPITALS

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays	220	260	270	285	295	1,330

Under Medicare's prospective payment system (PPS) for inpatient hospital services, special rules apply to providers designated as sole community hospitals (SCHs). At present, there are more than 700 SCHs, about 95 percent of which are located in rural areas. Thus, more than one-fourth of rural hospitals qualify for SCH status. Under the current rules, a hospital may be designated as an SCH if it meets specific criteria that define a sole provider of inpatient, acute care hospital services in a geographic area. In addition, many SCHs have been permitted to retain that status regardless of whether they meet the current sole-provider criteria.

Payments to SCHs are equal to the highest of three amounts: the regular PPS payment that would otherwise apply, an amount based on the hospital's costs in 1982 updated to the current year, or an amount based on the hospital's costs in 1987 updated to the current year. In addition, rural SCHs receive a higher "disproportionate share" adjustment--that is, a higher PPS adjustment for hospitals that treat a disproportionately large share of low-income patients--than other rural hospitals. As a result of the special rules, total PPS payments to SCHs for 1995 are estimated to be about 10 percent higher than they would be otherwise. If the special payment rules for SCHs were eliminated, total PPS payments would be $220 million less in 1996 and $1.3 billion less for the 1996-2000 period.

A primary objective of the SCH rules is to assist hospitals in locations where closings would threaten access to hospital care, but the support is not well aimed at essential providers. The group of hospitals qualifying for SCH payments includes, for example, some hospitals located in areas where there are other providers nearby. Moreover, whether an SCH actually receives higher payments under the special rules that permit payments to be based on a hospital-specific amount depends on whether its costs in either of the specified base years (1982 or 1987) were relatively high, not on its current financial condition.

If the special payment rules were eliminated, however, revenues of many sole community hopitals would be lower, which might cause financial distress for some of them. Because many SCHs are the sole providers of hospital services in their geographic areas, quality or access to care might be reduced in some rural locations.

ENT-38 REDUCE MEDICARE'S PAYMENTS FOR HOSPITALS' INPATIENT CAPITAL-RELATED COSTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Rebase Federal and Hospital-Specific Rates for Capital Payments						
Outlays	245	290	295	305	315	1,450
Rebase the Rates for Capital and Freeze Them for One Year						
Outlays	290	340	350	360	375	1,715
Reduce Capital Payments for PPS-Excluded Hospitals and Units by 15 Percent						
Outlays	125	160	185	215	250	935

In 1992, Medicare revised its method of paying hospitals for their inpatient capital-related costs by replacing cost-based reimbursement with a prospective payment method. Under the prospective system, hospitals receive a predetermined amount for each Medicare patient to pay for capital-related costs, which include depreciation, interest, taxes, insurance, and similar expenses for buildings and fixed and movable equipment. The prospective system applies to hospitals paid under Medicare's prospective payment system (PPS) for operating costs. For hospitals and certain units that are excluded from the PPS, such as psychiatric and rehabilitation hospitals and units, Medicare continues to pay for capital-related expenses on the basis of reasonable costs.

A fully prospective federal payment rate for capital costs is being phased in over 10 years. During the transition period, payments are determined by a complicated method based on a number of factors, including federal and hospital-specific payment rates. The federal and hospital-specific rates are increased annually. By 2001, all hospitals will receive the federal rate, adjusted for the hospital's mix of patients and certain other characteristics.

Recent data suggest that the initial federal and hospital-specific rates were overestimated. The 1992 rates were based on actual 1989 and 1990 data (for the federal rate and hospital-specific rates, respectively) projected to 1992, but more recent data indicate that the rate of growth of capital costs between 1989 and 1992 was slower than expected. Although the federal rate was reduced by 7.4 percent in the Omnibus Budget Reconciliation Act of 1993, the Health Care Financing Administration (HCFA) estimates that a further reduction of 5.62 percent in the federal rate and a reduction of 7.13 percent in the hospital-specific rates would be consistent with current data. Those reductions would yield savings of $245 million in 1996 and $1.5 billion for the 1996-2000 period.

If, in addition, capital-related payment rates were frozen for one year, total savings would rise to $290 million in 1996 and $1.7 billion over the 1996-2000 period. A justification for this version is that past capital costs and their growth rate might have been higher than warranted. In particular, HCFA estimates that the growth rate of per-case capital costs during the 1985-1992 period was greater than can be explained by changes in capital prices, the mix of patients treated by hospitals, and the "intensity" of hospital services.

A third option--which could be combined with either of the first two--would be to reduce capital-related payments to PPS-excluded hospitals and units. If payments to these facilities were lowered by 15 percent, savings would be $125 million in 1996

and $945 million over the five-year period. This approach would provide a greater incentive than under full reasonable-cost reimbursement for these hospitals and units to use capital efficiently.

Most hospitals would probably be able to adjust to these reductions by lowering their capital costs or partially covering them with other sources of revenue because Medicare's payments for capital costs are a small share of hospitals' revenues. Payments for inpatient capital-related costs constitute about 10 percent of Medicare's total payments for inpatient care, and less than 5 percent of hospitals' total revenues from all sources. Hospitals that are in poor financial condition, however, might have difficulty absorbing the reductions. As a result, their quality of care might decline, and they might provide fewer services to people without insurance.

ENT-39 ELIMINATE MEDICARE PAYMENTS TO HOSPITALS FOR ENROLLEES' BAD DEBTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays	265	320	340	360	380	1,670

Medicare beneficiaries are responsible for certain deductible and coinsurance amounts when they receive hospital inpatient services. For example, for calendar year 1995, the deductible amount for inpatient services is $716 per spell of illness. Currently, if the hospital makes a reasonable effort to collect these copayment amounts, Medicare will reimburse it for any remaining unpaid amounts. Eliminating these payments for enrollees' bad debts would reduce Medicare's payments to hospitals by $265 million in 1996 and almost $1.7 billion over the 1996-2000 period.

This option would give hospitals a financial incentive to expand their collection efforts, which would probably increase their recovery of enrollees' deductible and coinsurance amounts. Hospitals would not be able, however, to collect all the owed amounts. In particular, low-income enrollees who are not covered by Medicaid or other insurance may not be able to pay their hospital bills. As a result, this option would reduce revenues the most for those hospitals that are most likely to serve low-income Medicare patients. A drop in their Medicare payments might lead hospitals to cut back on the quality of their services or the amount of uncompensated care they provide, or to raise the rates they charge for other patients' care.

ENT-40 REVISE MEDICARE'S COST LIMITS FOR HOME HEALTH SERVICES AND SKILLED NURSING FACILITIES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
	Revise Limits for Home Health Services					
Outlays	10	303	463	524	575	1,875
	Revise Limits for Skilled Nursing Facilities					
Outlays	86	218	292	326	357	1,278

Medicare's payments for home health care and the routine services of most skilled nursing facilities are based on the provider's reasonable costs, subject to specified limits. The limit on payments for each home health agency is calculated as the sum of the individual limits for the different types of visits (such as home health aide, speech therapy, and physical therapy) provided by the agency. The individual limits are set at 112 percent of the national average cost per visit incurred by free-standing home health agencies for each type of service. The limits are adjusted for differences in wage rates among market areas and for urban or rural location. Although the individual limits are used to compute each agency's total limit, they are not individually binding on a per-visit or per-service basis.

Medicare's limit on payments for the routine services of skilled nursing facilities is based on 112 percent of the average cost per day for routine services in free-standing facilities. For hospital-based facilities, the limit is increased by one-half of the difference between the limit for free-standing facilities and 112 percent of the average routine costs per day for hospital-based facilities. Limits are computed separately for urban and rural areas and are adjusted for differences in wage levels. Costs for ancillary services (such as physical therapy, occupational therapy, and speech therapy) and for capital-related expenses are not subject to the limit. Ancillary services now account for more than half of Medicare's payments to skilled nursing facilities.

Usually, the cost limits are computed each year so that they reflect the growth in average costs among providers. The Omnibus Budget Reconciliation Act of 1993 (OBRA-93), however, froze the limits for both home health services and skilled nursing facilities for two years. The limits are frozen until July 1, 1996, for home health services and October 1, 1995, for skilled nursing facilities.

Under this option, the method of computing the limits for home health services and skilled nursing facilities would be revised to extend the savings from the OBRA-93 freeze. Under current law, the increases in the limits during 1996 would reflect all of the growth that had occurred in average costs for each type of service since the previous increase in limits. By contrast, under the option, the next increase in the limits would reflect only one year of growth in average costs. Specifically, the limits would be modified by lowering them from 112 percent of the relevant average cost. The Health Care Financing Administration estimates that the revised proportions would be just over 100 percent for home health services and about 100 percent for skilled nursing facilities. This change would cut Medicare spending by $96 million in 1996 and nearly $3.2 billion over the 1996-2000 period compared with spending under current law.

For some facilities, revising the limits would probably have little effect because the facilities have already adjusted to the lower limits set by the freeze

--for example, by increasing their efficiency or generating higher revenues from other sources. Beginning in 1996, the limits would rise each year with the growth in average costs. Other facilities, however, may have had difficulty coping with the freeze and may therefore find it hard to adjust to the revised limits. For example, using the latest available data, which are primarily from 1990, the Health Care Financing Administration estimated that 36 percent of home health agencies had costs that exceeded their limit, and 61 percent of agencies had costs that would have exceeded a limit based on 100 percent of average costs. As a result, this option might adversely affect access to services or the quality of those services for some Medicare beneficiaries.

ENT-41 CONTINUE MEDICARE'S TRANSITION TO PROSPECTIVE RATES FOR FACILITY COSTS IN HOSPITALS' OUTPATIENT DEPARTMENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays	45	40	35	35	40	195

The Supplementary Medical Insurance (SMI) portion of Medicare pays for services provided in hospitals' outpatient departments. It makes separate payments to the facility and to physicians. The facility component includes reimbursement for the services of nonphysician personnel, drugs and biological products, other health services, rent, and utilities. Medicare previously reimbursed hospitals' outpatient departments on a reasonable-cost basis for most services. The Omnibus Budget Reconciliation Act of 1986, however, changed Medicare's payment method for the facility costs of most surgical procedures performed in hospitals' outpatient departments. The reimbursement that hospitals receive for these procedures is now based on the lesser of reasonable costs or charges, or a blend of that hospital-specific amount and the prospective rate received by freestanding ambulatory surgical centers (ASCs) in the area. In 1987, the Congress enacted a similar change for paying facility costs associated with outpatient radiology and diagnostic services. For outpatient surgery and radiology services, the hospital-specific share is 42 percent and the prospective-rate share is 58 percent. For other diagnostic services, the hospital-specific and prospective-rate shares are equally divided.

Outpatient payments are one of the fastest-growing components of SMI expenditures, accounting for a projected 25 percent in 1995. Between 1996 and 2000, SMI outlays for hospital outpatient services are expected to increase at an average annual rate of about 16 percent. A major factor in this increase is technological progress that allows hospitals and physicians to substitute outpatient surgery and technology for inpatient procedures. Furthermore, under the current reimbursement system, which is roughly half cost-based, hospitals' incentives to reduce the expenses of ambulatory surgery or outpatient radiology are limited because they would realize only about half the savings caused by any cost reduction. By contrast, ASCs have strong incentives to control costs because they are reimbursed prospectively, as are physicians who provide radiology services in their offices.

Under this option, the hospital-specific portion of the blended reimbursement rate for costs related to the use of facilities for outpatient surgery, radiology, and diagnostic services would be phased out in 1997, with a transitional blend for 1996 of 25 percent of costs and 75 percent of the prospective rate. Savings from current-law SMI spending would be $45 million in 1996 and $195 million over the 1996-2000 period.

In addition to cutting Medicare's costs, this option would result in the same payment system for hospital outpatient departments and ASCs. Thus, it would reduce the incentive and ability of hospitals to compete for patients through costly capital acquisitions. Hospitals would also have stronger incentives to control the costs of outpatient surgery, radiology, and diagnostic services because they could no longer automatically pass part of those costs through to Medicare. Some people are concerned, however, that access to care for rural Medicare beneficiaries might deteriorate; small and rural hospitals are more dependent on outpatient revenue than larger hospitals, and there are fewer alternatives to outpatient hospital services in rural areas. In addition, if patients at risk of complications are advised to receive treatment in hospitals' outpatient departments rather than ASCs because of the ready availability of advanced support systems in hospitals, paying higher rates to hospitals than to ASCs might be appropriate.

ENT-42 INCREASE AND INDEX MEDICARE'S DEDUCTIBLE FOR PHYSICIANS' SERVICES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
			Indexed to SMI Charges per Enrollee			
Outlays	640	1,210	1,620	2,120	2,680	8,270
			Indexed to Consumer Price Index			
Outlays	640	1,070	1,190	1,340	1,460	5,700

One way to achieve appreciable federal savings in Medicare's Supplementary Medical Insurance (SMI) program is to increase the deductible--that is, the amount that enrollees must pay for services each year before the government shares responsibility. The deductible is now $100 a year and has been increased only three times since Medicare began in 1966, when it was set at $50. The deductible has fallen in relation to average annual per capita charges under the SMI program from 45 percent in 1967 to about 5 percent in 1994. In relation to the average annual Social Security benefit, the deductible has dropped from 5 percent in 1967 to 1 percent in 1994.

Increasing the SMI deductible to $150 on January 1, 1996, would save $640 million in fiscal year 1996. If the new deductible was indexed to the rate of growth in SMI charges per enrollee for 1997 and later years, savings would be $8.3 billion over the 1996-2000 period. By 2000, the deductible amount would be $227. If the deductible was tied to the consumer price index instead, savings would be $5.7 billion over the 1996-2000 period, and the deductible amount would be $169 in 2000.

An increase in the deductible amount would enhance the economic incentives for prudent consumption of medical care, while spreading the impact among most enrollees. No enrollee's out-of-pocket costs would rise by more than $50 in 1996.

The additional out-of-pocket costs under this option might, however, discourage some low-income enrollees who are not eligible for Medicaid from seeking needed care. In addition, costs to states would increase because their Medicaid programs pay deductible amounts for Medicare enrollees who also receive Medicaid benefits.

ENT-43 INCREASE THE COINSURANCE RATE FOR PHYSICIANS' SERVICES UNDER MEDICARE TO 25 PERCENT

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays	1,370	2,230	2,510	2,890	3,360	12,360

Currently, the coinsurance rate on most services provided under Medicare's Supplementary Medical Insurance (SMI) program is 20 percent. One exception is outpatient psychiatric services, for which the coinsurance rate is 50 percent. The other exceptions are clinical laboratory services and home health care, which have no coinsurance requirements.

If, beginning on January 1, 1996, enrollees were required to pay coinsurance rates of 25 percent on all SMI services that are currently subject to a rate of 20 percent, savings to Medicare would be $1.4 billion in fiscal year 1996. Over the 1996-2000 period, savings would be $12.4 billion. Savings would be larger if coinsurance requirements were imposed on laboratory services and home health care as well.

This option would reduce Medicare's costs for two reasons. First, the higher coinsurance rate would reduce use of services by Medicare enrollees who do not have supplementary insurance coverage. Second, Medicare would be responsible for a smaller share of the costs of the services that enrollees use.

This option would, however, increase the risk of very large out-of-pocket costs for the 25 percent of enrollees who have no supplementary coverage and would probably increase medigap premiums for the 30 percent of enrollees who purchase supplementary insurance. Moreover, it would increase states' Medicaid costs for the 15 percent of enrollees who receive full or qualified Medicaid benefits.

ENT-44 COLLECT 20 PERCENT COINSURANCE ON CLINICAL LABORATORY SERVICES UNDER MEDICARE

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays	510	800	890	1,030	1,160	4,390

Medicare currently pays 100 percent of the approved fee for clinical laboratory services provided to enrollees. Medicare's payment is set by a fee schedule and providers must accept that fee as full payment for the service. Beneficiaries pay coinsurance of 20 percent for most other services provided under Medicare's Supplementary Medical Insurance (SMI) program (as they did for clinical laboratory services before July 1984, when a fee schedule that reduced payment rates was put in place).

Reimposing the coinsurance requirement for laboratory services would yield appreciable savings to Medicare. If coinsurance of 20 percent of laboratory fees was imposed beginning January 1, 1996, federal savings would be $510 million in fiscal year 1996 and would total nearly $4.4 billion over the 1996-2000 period.

In addition to reducing Medicare's costs, this option would make cost-sharing requirements under the SMI program more uniform and therefore easier to understand. Moreover, enrollees might be somewhat less likely to have laboratory tests with little expected benefit if they paid part of the costs.

Cost sharing probably would not substantially affect the use of laboratory services by enrollees, however, because decisions about what tests are appropriate are generally left to physicians, whose decisions do not appear to depend on enrollees' cost sharing. Hence, the Congressional Budget Office assumes that a small part of the savings under this option would be the result of more prudent use of laboratory services, but most of the expected savings would reflect the transfer to enrollees of costs now paid by Medicare. Billing costs for some providers, such as independent laboratories, could be significantly higher because they would have to bill both Medicare and enrollees to collect their full fees. Currently, they have no need to bill enrollees directly for clinical laboratory services. In addition, states' Medicaid costs would increase for enrollees who also receive Medicaid benefits.

ENT-45 COLLECT 20 PERCENT COINSURANCE ON ALL HOME HEALTH AND SKILLED NURSING FACILITY SERVICES UNDER MEDICARE

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays for Home Health	2,381	3,898	4,513	4,985	5,463	21,240
Outlays for Nursing	244	461	567	652	752	2,676
Total	2,625	4,359	5,080	5,637	6,215	23,916

Copayments are not currently required from enrollees for home health services under Medicare. Copayments for skilled nursing facility (SNF) services are required for each day after the first 20 days of care; the coinsurance amount per day is equal to one-eighth of the deductible amount for hospital care and is unrelated to SNF costs.

If enrollees were required to pay coinsurance amounts equal to 20 percent of the projected average cost for each home health visit and each SNF day, the net savings to Medicare would be $2.6 billion in 1996. Over the five-year projection period, savings would be $23.9 billion.

This option, together with the laboratory coinsurance requirement discussed in ENT-44, would establish a uniform coinsurance rate of 20 percent on almost all Medicare services. This uniform rate would make Medicare's copayment requirements easier for providers and patients to understand. Further, because coinsurance amounts would be based on the cost of services, they would encourage enrollees who lack supplementary insurance coverage to consider relative costs appropriately when choosing among alternative treatments. As a result, the use of home health and SNF services might fall. Only hospital inpatient services would require no copayments (for most stays) except for the deductible amount. But under the prospective payment system, patients are unlikely to remain hospitalized longer than necessary because hospitals have strong incentives to discharge them quickly.

Many enrollees have supplementary insurance that eliminates their Medicare copayment costs, and this option would not affect their use of services. It would, however, increase medigap premiums for about 30 percent of enrollees who purchase that kind of supplementary insurance, and it would increase state's Medicaid costs for the 15 percent of enrollees who also receive Medicaid benefits. Moreover, this option would increase the risk of very large out-of-pocket costs for the 25 percent of enrollees who lack any supplementary coverage.

ENT-46 PROHIBIT FIRST-DOLLAR COVERAGE UNDER MEDIGAP POLICIES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Outlays	4,220	6,630	7,280	7,990	8,800	34,920

About 30 percent of Medicare enrollees purchase supplementary private insurance (medigap coverage) that pays all or most of Medicare's copayment requirements for them. Medigap policyholders use about 24 percent more services than they would if they did not have first-dollar coverage. But most of the costs of these additional services are paid by the federal government through Medicare, not by medigap insurers.

Federal costs for Medicare could thus be reduced if medigap plans were prohibited from offering first-dollar coverage for Medicare's copayment requirements. If, for example, medigap plans were prohibited from paying any portion of the first $1,500 of an enrollee's copayment liabilities for the year, use of medical services by medigap policyholders would fall, and federal savings for 1996 would be $4.2 billion. Assuming that the medigap limit would be linked to growth in the average value of Medicare's copayment requirements for later years, savings over the 1996-2000 period would total $34.9 billion. This estimate includes savings from medigap plans provided by employers as a benefit for retirees.

Only enrollees who have medigap policies would be directly affected by this option, and most of them would be financially better off under it. Because their medigap premiums would decrease more than their out-of-pocket liabilities would increase, most medigap enrollees would have lower expenses during the year under this approach. Indirectly, all enrollees might be better off because Medicare's premiums would be lower than under current law.

Medigap holders would have to assume a higher level of financial risk for Medicare-covered services than they do now, however. Because they might feel more uncertain about their expenses, some policyholders might object to eliminating their option to purchase first-dollar coverage even if in most years they would be financially better off. Moreover, about a quarter of people with medigap policies would actually incur higher expenses in any given year, and those with expensive chronic conditions might be worse off year after year. Finally, the decrease in use of services by medigap holders that would generate federal savings under this option might not be limited to unnecessary care, so the health of some of them might be adversely affected.

ENT-47 INCREASE THE PREMIUM FOR PHYSICIANS' SERVICES UNDER MEDICARE TO 30 PERCENT OF PROGRAM COSTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Outlays	2,660	3,900	4,390	6,330	9,020	26,300

Benefits under Medicare's Supplementary Medical Insurance (SMI) program are partially funded by monthly premiums paid by enrollees, and the remainder are paid from general revenues. Although the SMI premium was initially intended to cover 50 percent of the cost of benefits, between 1975 and 1983 premium receipts covered a declining share of SMI costs--falling from 50 percent to less than 25 percent. This drop occurred because premium increases were limited by the cost-of-living adjustment (COLA) for Social Security benefits (which is based on the consumer price index), but the per capita cost of the SMI program increased faster. Since 1984, premiums have been set to cover about 25 percent of average benefits for an aged enrollee, although under current law the COLA will again determine the premium adjustment beginning with the 1999 increase.

If the premium was set to cover 30 percent of benefits for 1996 and all years thereafter, $2.7 billion would be saved in 1996 and $26.3 billion over the 1996-2000 period. The premium for 1996 would be $54 a month instead of $45. These estimates assume a continuation of the current hold-harmless provision, which ensures that no enrollee's monthly Social Security check will fall as a result of the Social Security cost-of-living adjustment (which is based on the whole benefit) being smaller than the SMI premium increase.

Most SMI enrollees would pay a little more under this option, in contrast to proposals--such as increasing copayments--that could substantially increase the out-of-pocket costs of those who become seriously ill. This option need not affect enrollees with income below 120 percent of the federal poverty threshold because all of them are eligible to have Medicaid pay their Medicare premiums, although some who are eligible for Medicaid do not apply for benefits.

Low-income enrollees who are not eligible for Medicaid, however, could find the increased premium burdensome. A few might drop Supplementary Medical Insurance coverage and either do without care or turn to sources of free or reduced-cost care, which could increase demands on local governments. In addition, states' expenditures would rise because states would pay part of the higher premium costs for those Medicare enrollees who also receive Medicaid benefits.

ENT-48 RELATE THE PREMIUM FOR PHYSICIANS' SERVICES UNDER MEDICARE TO ENROLLEES' INCOME

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
50 Percent Ceiling						
25 Percent Basic Premium	0	0	0	1,329	3,387	4,716
Income-Related Premium	960	1,554	1,851	2,205	2,627	9,197
Total	960	1,554	1,851	3,534	6,014	13,913
100 Percent Ceiling						
25 Percent Basic Premium	0	0	0	1,329	3,387	4,716
Income-Related Premium	633	1,185	1,429	1,724	2,080	7,051
Total	633	1,185	1,429	3,053	5,467	11,767

Instead of increasing the basic premium to 30 percent of costs for all enrollees under the Supplementary Medical Insurance (SMI) program, this option would collect relatively more from higher-income people. Under one version, individuals with modified adjusted gross income of less than $50,000 and couples with income lower than $65,000 would pay only the basic premium, set at about 25 percent of SMI costs per enrollee. Premiums would rise progressively for higher-income enrollees, however. The maximum total premium would be set to cover 50 percent of costs for individuals with income exceeding $60,000 and for couples with income exceeding $80,000.

Under a second version, nearly the same five-year savings could be achieved by setting the maximum total premium to cover 100 percent of costs for individuals with income exceeding $125,000 and for couples with income over $150,000. Under this version, income-related premiums would begin at $100,000 for individuals and $125,000 for couples. In both cases, the income-related premiums would have to be collected through the income tax system so that rates could be aligned with income. Current premiums are deducted automatically from Social Security checks for most enrollees.

If the 50 percent option was carried out for calendar year 1996, savings would total $960 million in fiscal year 1996 and $13.9 billion over the 1996-2000 period. Under the 100 percent option, savings would total $11.8 billion over the five-year period. These estimates assume that the current hold-harmless provisions would continue only for people subject to the basic 25 percent premium. (The hold-harmless provisions ensure that no enrollee's Social Security check will decrease because an increase in the SMI premium exceeds the cost-of-living adjustment.)

Most SMI enrollees would be unaffected by the portion of the premium that is related to income. Under the 50 percent option, roughly 92 percent of enrollees would face the basic 25 percent premium, about 6 percent would pay the maximum premium, and 2 percent would pay a premium somewhere in between. Under the 100 percent option, only about 2 percent of enrollees would be subject to the income-related premium.

Enrollees subject to the income-related premium would pay substantially more, however. Under the 50 percent option, the maximum monthly premium for 1996 would be $89.10 instead of the $44.60 pre-

mium projected under current law. Under the 100 percent option, the maximum monthly premium would be $178.20. That change might lead some enrollees to drop out, although it is estimated that fewer than 0.5 percent would do so. Those with retirement health plans that do not require Medicare enrollment (largely retired government employees) would be most likely to drop out. Some healthy enrollees who have no other source of health insurance might do so as well, if they were not averse to the risk that they might incur large health care costs.

ENT-49 MODIFY THE PROCESS FOR UPDATING PHYSICIANS' FEES UNDER THE MEDICARE FEE SCHEDULE

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Outlays	410	820	1,350	1,880	2,150	6,610

Constraining growth in the volume of physicians' services is an important component of Medicare's cost containment objectives. The volume performance standard (VPS) has been Medicare's principal tool for moderating growth in spending for physicians' services under the Medicare fee schedule (MFS). Unless the Congress overrides the default process, fees under the MFS are updated by the increase in an index of physicians' costs (the Medicare economic index, or MEI), modified by a penalty or bonus determined by how much growth in the volume of services in a previous period exceeded or fell below targets set by the VPS.

In its 1994 annual report, the Physician Payment Review Commission recommended five modifications to the VPS: 1) limit each update to no more than 5 percentage points above the MEI, matching the limit on reductions that is currently in place; 2) base each update on the cumulative disparity between actual growth and VPS targets from some base year (say 1994), instead of on the disparity only for the previous year; 3) incorporate VPS penalty adjustments to the update into the targets in the same way that the adjustments are set by law (that is, with no offsetting increase in volume assumed); 4) base target allowances for volume increases on historical growth in real gross domestic product per capita (plus, say, 1 percentage point to account for new technology) instead of on historical growth in volume per enrollee minus the current "performance standard factor"; and 5) reestablish resource-based relative values for payment rates and maintain them by using a single target and update for all services, eliminating the separate targets and updates now existing for primary care, surgical, and other nonsurgical services. If the effects of different updates by service category in recent years on MFS rates were eliminated for 1996 in a budget-neutral way, and if the five recommendations described here were put in place and effective for the 1996 update, Medicare's spending under the MFS would be reduced by $410 million that year. Savings through 2000 would total $6.6 billion.

These modifications would improve the VPS as a tool for cost control. The first two would ensure that any spending above the target could be fully recovered in later years through smaller increases in payment rates. The third modification would eliminate an unintended effect of the current system of calculating the VPS, under which spending targets are increased for years in which a VPS penalty is imposed.

The fourth modification would link spending on services to growth in the nation's resources from which payment must come, and would enhance physicians' incentives to constrain increases in volume. Under the current system, a reduction of the growth in volume leads to an immediate increase in fees, but only at the expense of lower targets in the future; thus, it offers only a temporary reward for a permanent reduction in volume.

The fifth modification would restore the integrity of the resource-based relative value scale that was the foundation for the Medicare fee schedule, which was put in place to rationalize the basis for Medicare's physician payment rates. One of the objectives of the MFS was to improve payment rates for primary care in relation to specialists' services, in part because health care was expected to be less costly in a system less dominated by specialties. That objective has been undermined in recent years by the default update process, which has produced higher payment rate increases for specialists' services than for primary care services.

These changes would, however, reduce MFS rates significantly below what they would otherwise be. In 1996, for example, MFS rates would be 2.8 percent lower, and by 2000 they would be about 9 percent lower. Unless rates paid by other insurers dropped by similar amounts, Medicare's rates would further erode in relation to those of other payers, perhaps threatening access to mainstream health care for Medicare enrollees.

ENT-50 REDUCE FEDERAL EMPLOYEE RETIREMENT COSTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Defer COLAs for Retirees						
Military Retirement	0	410	880	1,810	2,380	5,480
Civilian Retirement	60	200	290	360	410	1,310
Limit Some COLAs Below Inflation						
Military Retirement	0	260	550	1,120	1,490	3,420
Civilian Retirement	90	330	530	750	970	2,670
Reduce COLAs to Middle- and High-Income Retirees						
Military Retirement	0	240	530	1,090	1,460	3,320
Civilian Retirement	170	620	1,000	1,390	1,800	4,980
Modify the Salary Used to Set Pensions						
Military Retirement	20	40	70	90	120	340
Civilian Retirement	10	40	70	110	160	390
Restrict Agency Match on Thrift Plan Contribution to 50 Percent						
Civilian Retirement[a]	320	460	490	520	550	2,340
Raise Employee Contributions						
Civilian Retirement[b]	740	1,780	2,080	2,130	2,230	8,960

a. Savings from the 1995 funding level adjusted for inflation.

b. Addition to current-law revenues.

About 4.5 million government employees are covered by federal civilian and military retirement programs. The Federal Employees' Retirement System (FERS) covers civilian employees hired since January 1984. FERS supplements Social Security, in which workers who are covered under FERS also participate. When FERS was created, workers hired before 1984 had the option to join. Most civilian employees not in FERS are covered by the Civil Service Retirement System (CSRS). Employees who are covered under CSRS do not participate in Social Security. Uniformed military personnel are covered by the Military Retirement System (MRS), which was revised for personnel entering the service after July 31, 1986, and by Social Security. Federal retirement payments totaled $63 billion in 1994.

There are three basic approaches to reducing the costs of federal retirement--namely, cutting benefits earned by employees, increasing employee contributions, or cutting benefits paid to retirees. The options described here differ according to who would be affected. The increase in contributions, for example, would affect workers who must contribute more of

their income toward future benefits. By contrast, the options limiting cost-of-living allowances (COLAs) would affect current and future retirees. Military retirees will not receive a COLA in 1996 under the provisions of the Omnibus Budget Reconciliation Act of 1993 (OBRA-93). Accordingly, the options to defer, limit, or reduce COLAs for military retirees show no savings in 1996. OBRA-93 also delayed COLA payments for civilian retirees for three months (until April 1996). The other options would affect current employees and future retirees.

It is important to note that the five-year cash estimates for the cuts in benefits described here represent only a small portion of the long-run savings that would result from a reduction in federal retirement costs. One reason is that the options are phased in at different rates, so the first year's cash savings are relatively small. Even more important, the cash flows and costs are accounted for differently in different options. For example, the bulk of the cash savings from modifying the salary used to compute pensions shows up years or decades in the future, when current employees retire. By contrast, the option of raising employee contributions counts as an immediate savings that future taxpayers will not have to pay for benefits. Given these differences, the relative size of savings over five years for each option may not be an accurate guide to the long-run advantage of each for reducing the budget. Moreover, the emphasis on five-year cash estimates makes options such as increasing the federal retirement age less attractive than they would be otherwise. Such an option, which was considered by the Bipartisan Commission on Entitlement and Tax Reform, has a large payoff in the longer run but not over the next five years.

The main argument for cutting federal retirement costs is that benefits are more generous than those typically offered by firms in the private sector. Reducing selected federal retirement benefits and increasing pay would produce a mix of current and deferred compensation that is more in line with standards in the private sector. Even if federal retirement was reduced in the manner described below, federal retirees would still receive benefits that exceed those typically afforded employees retiring from private firms. Depending upon how they are designed, some of the cuts in benefits could also promote efforts to reduce employment without layoffs because some workers would leave before reductions took effect. This would be especially true if employees were offered cash as an added inducement to resign. Cuts in retirement, moreover, probably hurt retention and recruitment less than salary cuts. Employees are likely to be more responsive to a salary cut that lowers their current standard of living than to a cut in the rate at which retirement benefits are earned that lowers their future standard of living.

The main argument against cutting retirement benefits is that such an action hurts both retirees and the government's ability to recruit a quality workforce. Supporters of federal workers and retirees point out that pensions are part of the employment contract between the government and its employees and therefore constitute earned benefits. They also argue that although certain provisions of retirement are generous, total compensation should be the basis of comparison between federal and private-sector employees. Annual surveys indicate that federal workers may be accepting salaries below private sector rates in exchange for better retirement benefits. In essence, these workers pay for their more generous retirement benefits by accepting lower wages during their working years. Moreover, as some observers maintain, cutting benefits that were promised to current annuitants may prompt forward-looking workers to demand higher pay now to offset the increased uncertainty of their deferred benefits.

One way to avoid some of the negative consequences of reductions in retirement benefits is to make such cuts apply only to new employees. Current employees could not argue that this prospective approach violates their labor contracts. The approach produces small savings in the short term but substantial savings in the future.

Defer Cost-of-Living Adjustments. The CSRS and the prereform MRS (covering new recruits before August 1, 1986) provide full cost-of-living protection to all retirees, even those who retire before they are 62 years old. That kind of inflation protection is expensive when compared with what is available under the largest and most generous private pensions. Deferring COLAs until age 62 for all nondisabled employees who retire before that age would yield savings of $6.8 billion over five years. (Nearly 80 percent of the estimated savings would derive from

MRS because more than one-half of its annuitants are nondisabled retirees under 62, most of whom retired in their 40s.) This COLA deferral would result in a loss of $8,900 over five years for a CSRS-covered annuitant under 62 with an average annuity of $18,600 in 1996. The average military retiree under 62 would lose $8,200 over five years based on an average annuity of $19,900 in 1996. (Differences in the scheduled dates for COLAs under OBRA-93 explain why this option would impose greater losses over the five-year period on the average annuitant who is covered by CSRS than on the average military retiree.)

If COLAs were deferred, the government's retirement costs would be moderated and more in line with the treatment of COLAs under FERS and the post-reform MRS. (Consistent with the MRS reforms, this option allows a catch-up adjustment at age 62 that reflects inflation after the date of retirement. Most retirees under FERS receive neither protection before age 62 nor a catch-up at 62.) Although the option would lower the compensation of affected workers after retirement, many retirees should be able to supplement their pensions by working--as most military retirees already do. Opponents note that this policy is especially tough on military retirees who are generally forced to retire after 20 to 30 years of service. As an alternative to eliminating COLAs, retirees who have not reached the age of 62 could be granted COLAs equal to one-half of the inflation rate with no catch-up provision. That option would offer retirees under 62 some insurance against excessive inflation. The plan parallels changes that were mandated in 1982 but subsequently repealed and would result in savings of about $3.9 billion over five years.

Limit Some COLAs. On average, private pension plans offset only about 30 percent of the erosion of purchasing power caused by inflation. By contrast, CSRS and the prereform MRS provide 100 percent automatic protection from inflation; however, some of this protection was temporarily taken away by delayed effective dates under OBRA-93.

This option would limit COLAs to 1 percentage point below the rate of inflation for the old MRS and to one-half point below inflation for CSRS. (The smaller half-point limitation for CSRS would apply to a more comprehensive benefit that, unlike the defined benefits under FERS and MRS, substitutes for both Social Security and employer-sponsored benefits. Therefore, the smaller cut would produce a reduction comparable to the one-point limit for MRS enrollees.) These changes would conform to the postretirement COLAs for employees covered by FERS and the revised MRS. This option, however, would hurt low-income retirees most. It would also renege on an understanding that workers in CSRS who passed up the chance to switch systems would retain their full protection against inflation. Savings would amount to $6.1 billion through 2000. (Savings from this option would decrease to $4.1 billion if it was coupled with the preceding one that would defer COLAs until age 62.) The average CSRS-covered retiree would lose $1,400 over five years, and the average military retiree would lose $6,400 over five years.

Reduce COLAs to Middle- and High-Income Retirees. Another alternative would tie the COLA reductions to beneficiaries' payment levels. The example discussed here would award the full COLA only on the first $630 of a retiree's monthly payment and a half COLA on the remainder. The $630 per month threshold is about equal to the projected 1996 poverty threshold for an elderly person and would be indexed to maintain its value over time. Similar proposals have been considered for Social Security.

This approach would save about $170 million in 1996 and $8.3 billion over the 1996-2000 period. The average CSRS-covered retiree would lose $2,400 over five years, and the average military retiree would lose $3,400. Because the full COLA would be paid only to beneficiaries with low annuities, this option would better target COLAs toward retirees with the greatest need for protection from inflation. Because retirees receiving FERS benefits already receive a reduced COLA, they would be less affected than those receiving CSRS benefits. Nonetheless, pension benefit levels are not always good indicators of total income. Furthermore, many people object to any changes in earned retirement benefits that might be construed as introducing a means test for benefits, even if the test is limited only to the COLA. They also point out that federal pensions are fully taxable

under the federal individual income tax in the same proportion that they exceed the contributions that employees made during their working years.

Modify the Salary Used to Set Pensions. Under current law, CSRS and FERS provide initial benefits based on an average of the employee's three highest-salaried years. MRS uses a different salary base for personnel hired before September 1980; benefits are calculated using a person's salary at the date of retirement. If, instead, a four-year average was adopted for CSRS and FERS and a 12-month average was adopted for MRS, initial pensions for most new retirees would be about 2 percent to 3 percent smaller, producing total savings through 2000 of $730 million. This option would align federal practice more closely with practice in the private sector, where five-year averages are common. In the long run, this option could encourage some employees to stay on another year in order to take full advantage, when calculating retirement benefits, of the higher salaries that may occur over time. That could help the government keep experienced people, but hinder efforts to reduce federal employment.

Restrict Matching Contributions. On behalf of any worker covered by FERS, federal agencies automatically contribute 1 percent of individual earnings to the Thrift Savings Plan (TSP). In addition, the employing agency matches any voluntary employee deposits dollar for dollar for the first 3 percent of pay and 50 cents for each dollar thereafter up to 5 percent of salary. The entire federal contribution for employees putting aside 5 percent amounts to a sum equal to 5 percent of pay. If the government limited its matching contributions to a uniform 50 percent rate against the first 5 percent of pay, the government's maximum contribution would fall to 3.5 percent of pay. Compared with current law, the discretionary savings from this proposal would total $2.3 billion over five years. (The estimates exclude savings realized by the Postal Service because it is now off-budget and reductions in its operating costs eventually benefit only mail users.) Assuming continuation of the automatic 1 percent match, this arrangement would remain superior to the coverage typically offered in the private sector.

Restricting the matching contributions would have several drawbacks. Middle- and upper-income employees rely on the government's matching contributions to maintain their standard of living during retirement, because Social Security replaces a smaller fraction of their income than it does for lower-income employees. Part of TSP's appeal derives from the fact that it provides individual accounts for each participant, the value of which cannot be eroded by subsequent changes in law. The security and portability of TSP was a major reason for the decision of many employees to switch to FERS, in which the defined benefit plan was inferior to that of CSRS. Changing the TSP provisions would be especially unfair to this group, whose decision to switch plans reasonably assumed that changes would not be made. Opponents of restricting the match rate also argue that this will diminish employees' savings for retirement, and this problem would be intensified if the cut reduced participation.

Increase Employee Contributions for Federal Civilian Pensions. As an alternative to cutting benefits, the government could reduce its retirement costs by increasing employee contributions. The strength of the federal retirement system lies in the indexed benefits that provide inflation protection that cannot be purchased in the private sector. Requiring employees to contribute to their retirement funds--an uncommon private-sector practice--is one way of offsetting this extra cost while maintaining a high level of salary replacement. On the downside, for most federal civilian employees, the option would be equivalent to a 2 percent pay cut without a drop in taxes. (See DOM-60 for further discussion of pay cuts.)

Currently, workers covered by CSRS contribute 7 percent of their salaries to their retirement fund, but they pay no Social Security taxes. The 0.8 percent contribution rate for FERS-covered employees, together with their 6.2 percent share of the Social Security tax, was set to equal the employees' contribution to CSRS. This option would increase both CSRS- and FERS-covered employees' contribution rates by 1 percentage point in January 1996 and by another point a year later. It would generate revenue of about $9 billion through 2000.

An alternative to this option would be to restrict the increased employee contributions to CSRS-covered employees. That alternative would raise

$4.5 billion in revenue over five years. Currently, the employees' 7 percent contribution and the employing agency's matching 7 percent contribution cover just 56 percent of the cost of CSRS pension benefits as earned. The Office of Personnel Management estimates that full funding of CSRS pension benefits would require contributions totaling 25.14 percent of payroll. Over time, the government makes additional payments that cover most of the remaining unfunded benefits. Raising the CSRS contribution rate to 9 percent over two years would lessen this "shortfall." Alternatively, the CSRS shortfall could be funded through higher agency contributions, even though that would not reduce the long-term cost to taxpayers. Higher agency contributions would confront managers with the true cost of labor and could improve program management and resource allocation.

There is no funding shortfall for FERS participants. Restricting the higher contributions to CSRS-covered employees, however, would lower their take-home pay in relation to similarly situated FERS-covered employees, which would penalize workers who chose to stay in CSRS in 1987 rather than join the new FERS. More CSRS-covered employees would have switched to FERS when they had the opportunity if they had known that their contribution rate would be increased.

The downside of increasing withholdings is that it threatens the government's ability to retain the experienced workforce covered by CSRS. According to recent survey data, only about 13 percent of private pension plans require additional employee contributions. But private-sector employees contribute 6.2 percent of their pay (up to $61,200 in 1995) for Social Security.

Raise the Retirement Age. The federal system generally permits retirement earlier than the private sector. Civilian employees can retire with immediate unreduced benefits at age 55 with 30 years of service, at 62 with 20 years of service, and at 65 with five years of service. As life expectancies have increased, Social Security and other retirement plans have raised retirement ages. Raising the retirement age would reduce federal retirement costs substantially. A number of options would reduce the generosity of federal retirement in the long run. Most savings, however, would occur far beyond the five-year period identified in this option, because it would be necessary to phase in such a reform over several years.

ENT-51 END OR SCALE BACK TRADE ADJUSTMENT ASSISTANCE

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
End Trade Adjustment Assistance						
Budget Authority	330	310	310	250	240	1,440
Outlays	250	290	310	260	250	1,360
Eliminate Trade Adjustment Assistance Cash Benefits						
Budget Authority	220	210	200	170	160	960
Outlays	220	210	200	170	160	960

The Trade Adjustment Assistance (TAA) program offers income-replacement benefits, training, and related services to workers unemployed as a result of import competition. To obtain assistance, such workers must petition the Secretary of Labor for certification and then meet other eligibility requirements. Cash benefits are available to certified workers receiving training, but only after their unemployment insurance benefits are exhausted.

Ending the TAA program would reduce federal outlays by $250 million in 1996 and by $1.4 billion during the 1996-2000 period. Affected workers could apply for benefits under title III of the Job Training Partnership Act (JTPA), which authorizes a broad range of employment and training services for displaced workers regardless of the cause of their job loss. Because funding for title III is limited, however, TAA cash benefits alone could be eliminated and the remaining TAA funds for training and related services could be shifted to title III. Savings under that option would total $960 million during the 1996-2000 period.

The rationale for these options is to secure under federal programs more equivalent treatment of workers who are permanently displaced as a result of changing economic conditions. Since title III of JTPA provides cash benefits only under limited circumstances, workers who lose jobs because of foreign competition are now treated more generously than workers who are displaced for other reasons.

Eliminating TAA cash benefits would, however, cause economic hardship for some of the long-term unemployed who would have received them. In addition, TAA now compensates some of the workers adversely affected by changes in trade policy. Some people argue, therefore, that eliminating TAA benefits could lessen political support for free trade, which economists generally view as beneficial to the overall economy.

ENT-52 INCREASE TARGETING OF CHILD NUTRITION SUBSIDIES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Change Subsidies in the School Lunch Program						
Budget Authority	50	370	430	450	470	1,770
Outlays	45	330	420	440	460	1,695
Reduce Subsidies to Family Day Care Homes						
Budget Authority	40	165	185	205	225	820
Outlays	35	145	180	200	220	780

Federal child nutrition programs were developed to improve the health and well-being of children by providing them with nutritious meals. The programs provide cash and commodity assistance to schools, child care centers, and family day care homes that serve meals to children.

Although most of the funds are earmarked for low-income children, some of the aid benefits middle- and upper-income children as well. In the National School Lunch Program (the largest of the child nutrition programs), most schools receive $1.76 in cash reimbursement for each meal served to children from families with income at or below 130 percent of the poverty line; a smaller subsidy of $1.36 for each meal served to children from families with income between 131 percent and 185 percent of poverty; and a subsidy of 17 cents a meal for children with family income above 185 percent of poverty. Schools are also given 15 cents' worth of commodities for each lunch served, regardless of the family income of the child. Reimbursements to family day care homes, which do not vary with the family income of the child, are $1.51 for each lunch and lesser amounts for other meals.

Change Subsidies in the School Lunch Program. Under this option, cash and commodity subsidies for school lunches served to children whose family income is above 350 percent of the poverty level would be eliminated. At the same time, school lunch subsidies for children from families whose income ranges from 131 percent to 185 percent of the poverty level would be increased by 20 cents.

Together, these changes would reduce federal expenditures by $1.7 billion during the 1996-2000 period. Eliminating the cash and commodity subsidies for all lunches served to children from families with income above 350 percent of the poverty line ($51,800 per year for a family of four in 1994) would reduce federal expenditures by $50 million in 1996, by $430 million in 1997, and by $2.2 billion during the 1996-2000 period. (These estimates assume that the changes would be effective on July 1, 1996.) The higher subsidies called for in the second part of the option would increase federal expenditures by $500 million during the five-year period.

In these estimates, the Congressional Budget Office assumes that the reduction in federal subsidies would lead a small number of schools--those serving relatively few lunches to children from families with low income--to discontinue the program for all students. The savings resulting from schools' dropping out of the program are an estimated $250 million over five years.

Although most of the federal funds are earmarked for low-income children, about one-fifth of the children who participate in the school lunch program have family income above 350 percent of the poverty line. These children are less in need of federal subsidies, and the targeting of this assistance

would be improved by limiting it to those from families with the lower income. Increases in the subsidies for meals served to children in families with income from 131 percent to 185 percent of the poverty level would, in effect, redistribute some of the child nutrition subsidies from higher-income students to this group.

Such changes would probably result in lower participation among children who are not poor because participation falls when prices rise. Participating schools would probably increase the price charged to children who are not poor to make up the loss in reimbursements unless state and local governments provided additional support. Children who dropped out of the program could receive meals of lower quality, since the meals qualifying for reimbursement are nutritionally adequate, whereas those from alternative sources might not be. Moreover, if the decline in participation was substantial, low-income children could become the main recipients of the meals and thus could be identified as poor by their peers. Finally, a few schools in which children who are not poor provide a large share of the total revenue for the meal program would probably drop out when participation fell, thereby eliminating federally subsidized meals for the low-income children attending them.

Reduce Subsidies to Family Day Care Homes. This option would lower subsidies for meals served in family day care homes, effective July 1, 1996. For homes located in low-income areas or homes run by providers with income below 185 percent of poverty, subsidies would remain unchanged from their levels under current law. At the option of the provider, subsidies at the current level could also be retained for any children from families with income below 185 percent of poverty. In other homes or for other children, the subsidies would be reduced by 21 cents for snacks, 25 cents for lunches, and 31 cents for breakfasts. Organizations sponsoring family day care homes would receive an additional $10 a month in administrative costs for each home in a low-income area. This option would lower federal expenditures by $780 million during the 1996-2000 period.

This option would also improve the targeting of federal aid. About three-quarters of the children cared for in family day care homes have family income above 185 percent of the poverty line and are less in need of government subsidies than are lower-income children. In the face of reduced subsidies, however, some providers would lower the quality of meals served to children in their care, raise costs of care to parents, or even cease to do business. In the last case, the supply of child care would fall. Moreover, because the increased payment for administrative costs would apply only to homes in low-income areas, other providers--or their sponsoring organizations--would incur additional administrative costs if they wanted to keep the higher subsidies.

ENT-53 ELIMINATE SMALL FOOD STAMP BENEFITS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	60	60	65	65	70	320
Outlays	60	60	65	65	70	320

The Food Stamp program provides coupons that enable low-income householders to buy a low-cost but nutritionally adequate diet. Among all programs providing assistance to low-income people, its reach is the greatest, encompassing all types of households, from the elderly living alone to two-parent families with children.

Because the benefits to which a household is entitled decline as its income rises, some households can receive only small amounts of food coupons each month. For one- and two-person households, a special rule increases the food coupons they receive to $10 a month currently and to $15 a month beginning in 1998 under Congressional Budget Office estimates, even if their net income indicates a smaller coupon amount. (The jump in 1998 reflects indexing of the minimum benefit coupled with rounding to the nearest $5.)

This option would eliminate the special rule that ensures a $10 or $15 minimum benefit for eligible households with one or two people, and would also eliminate any food stamp benefits of less than $10 a month for all households, thereby reducing federal expenditures by $60 million in 1996 and by $320 million during the 1996-2000 period. These savings include an estimated $9 million a year from lower administrative costs. Approximately 440,000 households, three-fifths of which are composed of elderly people, would lose their food stamp benefits entirely. Another 150,000 would receive reduced benefits in 1998 and beyond.

Carrying out this option would make administering the Food Stamp program more cost-effective because a large number of households that receive small monthly benefits would no longer have to be served. It would also eliminate the special treatment of one- and two-person households. Finally, such a change would foster consistency between the Food Stamp program and the Aid to Families with Dependent Children program, which does not pay benefits of less than $10 a month.

At the same time, this option would reduce by as much as $120 a year the effective incomes of households in which incomes are already low. Even though the households that would be affected are those with the highest incomes among food stamp recipients, their incomes are usually close to the poverty threshold.

ENT-54 REDUCE THE $20 EXCLUSION FROM INCOME IN SUPPLEMENTAL SECURITY INCOME

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	175	185	195	200	210	965
Outlays	175	185	195	200	210	965

The Supplemental Security Income (SSI) program provides federally funded monthly cash payments, based on uniform, nationwide eligibility rules, to needy aged, blind, or severely disabled people. In addition, all but eight states and jurisdictions provide supplemental payments. As a means-tested program, SSI's benefits are reduced by recipients' outside income, subject to certain exclusions. For unearned income--most of which is Social Security--the first $20 a month is excluded and any additional amounts reduce benefits dollar for dollar. Earned income is excluded more liberally, and any of the $20 exclusion that is not applied to unearned income is applied to earned income.

Reducing the monthly $20 exclusion to $15 would save $175 million in 1996 and almost $1 billion over the 1996-2000 period. A program that ensures a minimum living standard for its recipients need not provide a higher standard for people who happen to have unearned income, as illustrated by the absence of any standard exclusion for unearned income (other than child support) in the Aid to Families with Dependent Children program.

Nevertheless, reducing the monthly $20 exclusion by $5 would decrease by as much as $60 a year the incomes of the roughly 2.7 million low-income people--approximately 46 percent of all federal SSI recipients--who now benefit from the exclusion. Even with the full $20 exclusion, incomes of most SSI recipients fall below the poverty threshold.

ENT-55 RESTRICT LEGAL IMMIGRANTS' ELIGIBILITY FOR WELFARE PROGRAMS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
			Eliminate Eligibility			
SSI	50	2,200	2,300	2,300	2,500	9,350
Medicaid	50	1,850	1,900	1,900	2,000	7,700
Food Stamps	0[a]	1,200	1,150	1,100	1,050	4,500
AFDC	0[a]	500	450	450	400	1,800
Total	100	5,750	5,800	5,750	5,950	23,350
			Extend Deeming Period Until Citizenship			
SSI	125	500	880	1,170	1,570	4,245
Medicaid	10	30	50	70	85	245
Food Stamps	40	95	120	130	135	520
AFDC	10	25	35	40	45	155
Total	185	650	1,085	1,410	1,835	5,165
			Extend Deeming Period to Five Years			
SSI	0	40	130	180	210	560
Medicaid	0	5	10	10	15	40
Food Stamps	10	30	45	50	50	185
AFDC	5	15	15	15	15	65
Total	15	90	200	255	290	850

a. Under current law, both benefits and certain administrative costs in these programs are mandatory. Small savings in benefits in 1996 are likely to be offset by additional administrative costs.

Legal immigrants who have not become U.S. citizens are eligible for benefits from the Supplemental Security Income (SSI), Aid to Families with Dependent Children (AFDC), Food Stamp, and Medicaid programs if they meet the regular requirements for those programs. Illegal aliens are eligible only for emergency Medicaid assistance.

Legal immigrants, however, are subject to a requirement that does not apply to citizens. Immigrants who have sponsors must include a portion of their sponsor's income when the means test for eligibility is applied. In other words, some of the sponsor's income is "deemed" to the immigrant. The deeming process makes some immigrants ineligible for benefits they could otherwise receive.

The deeming period for AFDC and food stamps is three years. The deeming period for SSI was temporarily raised to five years, but in October 1996 it will revert to three years. Furthermore, deeming for SSI does not apply if an immigrant becomes disabled after entering the country. There is no deeming requirement specific to aliens.

Of the three options considered here, the largest savings over the next five years--$23.3 billion--would come from eliminating all benefits except emergency Medicaid assistance for all legal immigrants who are not refugees. A one-year grace period would allow legal immigrants residing in the United States who are eligible for assistance at the option's enactment to receive benefits for the first year. The majority of savings would come from SSI and Medicaid. When estimating savings, the Congressional Budget Office (CBO) has taken into account potential changes in the rate at which immigrants would naturalize in order to obtain benefits.

Another option would be to continue deeming for immigrants until they became citizens. Immigrants generally are not permitted to become citizens until five years after they enter the United States. The option would save $5.2 billion over the five-year period, again with most of the savings coming from SSI and Medicaid. As under the previous option, CBO assumed that some immigrants would naturalize if the plan was adopted.

The option that would offer the least savings over five years--$850 million--would permanently extend the deeming period to five years for all four programs. Since most legal immigrants cannot naturalize until five years after they enter the country, changes in naturalization rates would not affect this estimate.

There are several arguments, aside from savings, in favor of these options. First, some supporters of these measures question immigrants' commitment to the United States if they do not naturalize, and thus contend that they are not entitled to assistance. Second, these options would promote more responsibility among immigrants' sponsors. Third, restricting public assistance might speed immigrants' integration into the American economy and culture. Finally, some people worry that allowing immigrants to collect welfare benefits encourages the influx of people with few skills who may compete for jobs with low-skilled citizens.

There are, however, several arguments for not adopting these options. Legal immigrants enter the country with government permission, many pay taxes, and some can be called to serve in the armed forces. Therefore, opponents of these restrictions argue, legal immigrants who are needy deserve welfare benefits. Second, removing benefits would lower the living standards of vulnerable groups of immigrants, including children, the elderly, and the disabled, many of whom eventually become citizens. Finally, since it is unconstitutional for states to use immigrant status in determining eligibility for state-run programs, adopting these measures would probably increase the cost of states' programs providing general assistance.

ENT-56 LIMIT SPENDING IN THE EMERGENCY ASSISTANCE PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	325	395	485	580	640	2,425
Outlays	325	395	485	580	640	2,425

The Emergency Assistance (EA) program allows states to provide short-term aid to needy families with children in order to "avoid destitution" of the children or to provide living arrangements for them. As authorized under title IV-A of the Social Security Act, funding is shared equally by federal and state governments.

At the beginning of fiscal year 1991, 29 states had EA programs, which focused on assistance after natural disasters or crises threatening family living arrangements. During the late 1980s and early 1990s, federal spending on EA programs ranged from about $125 million to $175 million a year. Now, however, all but three states have emergency assistance programs and many states have expanded assistance into new service areas, such as emergency foster care or family preservation activities that might diminish the need for foster care. As a result, federal spending jumped sharply to an estimated $550 million in 1994 and is expected to reach $1.1 billion in 2000 under current law.

This option would limit federal EA spending to $500 million annually. That amount falls between spending levels before the upsurge and estimated spending for the current fiscal year. Limiting EA spending would save an estimated $325 million in 1996 and $2.4 billion during the 1996-2000 period. The limit could be accomplished either by setting a program cap or by converting the program to a block grant. Funds could be distributed among states in proportion to current spending, or a different mechanism could be used so that states that have not already increased their spending would not be placed at a disadvantage.

Much of the increased EA spending appears to represent a shifting of state spending to the federal government, rather than an increase in services to needy families. In addition, a new Family Preservation and Support Services program, enacted in the Omnibus Budget Reconciliation Act of 1993, entitles states to $930 million in federal funds during the 1994-1998 period to meet some of the same needs of children that the EA expansions cover. Nonetheless, under this option many states would receive less funding than they have in the recent past. Moreover, if states did not offset reduced federal funds, some of the most vulnerable children--for example, victims of abuse--could be hurt. Also, if family preservation services are successful in avoiding placement of children in foster care--and good information on whether there is such a relationship is not available--any reduction in EA funding could increase federal spending on foster care.

ENT-57 ELIMINATE THE $50 CHILD SUPPORT PAYMENT TO AFDC FAMILIES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	110	120	120	130	140	620
Outlays	110	120	120	130	140	620

The Child Support Enforcement program collects child support payments from noncustodial parents on behalf of families receiving Aid to Families with Dependent Children (AFDC). These payments are largely used to offset federal and state costs for AFDC. Amounts up to the first $50 in monthly child support collected, however, are paid to the AFDC family, without affecting the level of AFDC benefits. In essence, this policy means that AFDC families for whom noncustodial parents contribute child support get as much as $50 more a month than do otherwise identical families for whom such contributions are not made.

Eliminating the $50 child support payment to AFDC families would save the federal government $110 million in 1996 and $620 million through 2000. Stopping such payments would end the differential treatment of AFDC families that depends on whether the noncustodial parent pays child support. Administrative complexity would also be reduced.

Nevertheless, the child support payment provides an incentive for custodial parents to make an effort to obtain support. If the payment was eliminated, recipients of AFDC would be no better off when noncustodial parents paid child support than when they did not, perhaps reducing recipients' cooperation in seeking such payments. Noncustodial parents also might reduce their child support payments if this option was enacted, although new enforcement tools such as the withholding of wages might make it difficult for many to do so. In either case, the well-being of the children in these families would be adversely affected.

ENT-58 REDUCE THE FEDERAL MATCHING RATE AND INCREASE FEES IN THE CHILD SUPPORT ENFORCEMENT PROGRAM

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Reduce the Federal Matching Rate						
Budget Authority	590	650	710	770	830	3,550
Outlays	590	650	710	770	830	3,550
Charge Fees for Services						
Budget Authority	270	290	320	350	380	1,610
Outlays	270	290	320	350	380	1,610

NOTE: These estimates do not take into consideration the interaction between the two options, which is noted in the discussion.

Enacted in 1975, the Child Support Enforcement (CSE) program provides administrative tools and funding that states can use to improve the payment of child support by absent parents. The federal government helps states finance their CSE efforts by paying 66 percent of the costs and making incentive payments. As a result of this federal funding and because states keep a portion of child support collections, they saved $486 million in 1993. By contrast, the federal government incurred costs of about $764 million in 1993, after accounting for the share of child support collections that is allotted for reducing welfare payments.

Reduce the Federal Matching Rate. The Congressional Budget Office estimates that lowering the federal matching rate from 66 percent to 50 percent in 1996 and subsequent years would save $590 million in 1996 and $3.6 billion through 2000, although the amount of savings could vary, depending on how states reacted to the change. Under CBO's assumptions, states would continue to save money in 1996 and 1997 but would experience growing net costs thereafter.

Reducing the federal share of CSE costs would alter the balance of costs and savings between the federal and state governments, decreasing both federal costs and state savings. Although a higher matching rate may have been needed in the past to induce states to set up CSE programs, such programs are now operating and cannot be dismantled without financial penalty. Also, this option would encourage states to improve the efficiency of their CSE efforts, since they would pay a larger share of the costs of inefficiencies, and could thus produce even lower program costs.

Lowering the matching rate would entail some risks, however. Because caseloads for child support workers are already high, it is unlikely that states could improve efficiency enough to offset the reduction in federal payments. Thus, they might cut CSE services, thereby reducing child support collections. The lower CSE collections for families receiving payments under the Aid to Families with Dependent Children (AFDC) program would decrease state revenues from that source, but some states still might be better off financially if they cut CSE services, because states with low incomes may receive only a small share--as low as 22 percent--of child support collected. Further, states receive only small financial benefits from child support collections for non-AFDC families. They might, therefore, be even more likely to cut back on efforts for those families, thereby lowering the children's living standards.

Charge Fees to Some Families. Although states are required to charge application fees for furnishing child support services to non-AFDC families, many states charge only nominal amounts. In 1994, child support enforcement agencies collected fees amounting to $33 million, or less than 2 percent of total program costs. This option would require states to charge non-AFDC families a fee of $25 at the time they applied for services and a fee equal to 5 percent of any child support collected for them. Some flexibility could be given to states by allowing them to charge the annual user fee to either the custodial or the absent parent, to exempt low-income families but charge more to higher-income families, or to pay the fee directly to the federal government without charging families.

By charging these fees, the federal government would save $270 million in 1996 and $1.6 billion through 2000, at the current 66 percent federal matching rate. With a matching rate of 50 percent, as discussed above, savings would decline to $200 million in 1996 and $1.2 billion through 2000. If fees were set to recover all costs for non-AFDC families in the CSE program, they would have to equal about 15 percent of collections for those families.

In view of the substantial services that many families receive from the CSE agencies, those fees would be a modest contribution toward meeting their costs. Charging fees could discourage some custodial parents from seeking assistance, however, potentially reducing collections of child support. The families most likely to be discouraged would probably be those most in need of the income, unless states chose to exempt low-income families from paying the fees. In addition, with immediate wage withholding for most new or modified child support orders in place and operating through CSE agencies, some families who did not want--or need--the CSE services would nonetheless have to pay the collection fee.

ENT-59 REDUCE THE REPLACEMENT RATE WITHIN EACH BRACKET OF THE SOCIAL SECURITY BENEFIT FORMULA

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays	160	620	1,290	2,100	2,940	7,110

Under current law, the basic Social Security benefit is determined by a formula that provides workers with 90 percent of their average indexed monthly earnings (AIME) up to the first bend point (which defines the first earnings bracket), plus 32 percent of the AIME in the second bracket, plus 15 percent of the AIME above the second bend point. One method of reducing initial Social Security benefits would be to lower these three rates by a uniform percentage.

Lowering the three rates in the benefit formula from 90, 32, and 15 percent to 87.3, 31.0, and 14.6 percent, respectively, would achieve an essentially uniform 3 percent reduction in the benefits of newly eligible workers starting in 1996. Thus, a 62-year-old retiree who has always earned the average wage would receive initial benefits in 1996 of about 33 percent of preretirement earnings, compared with 34 percent if no change was made.

This reduction in the replacement rates would lower Social Security outlays by about $7.1 billion over the 1996-2000 period and by more in later years. Moreover, this option would reduce the benefits of all future retirees by essentially the same percentage. Furthermore, the option could be combined with a one-time cut in the cost-of-living adjustment to ensure that benefits for both current and future recipients would be reduced to a similar extent (see ENT-67). The combination would generate substantial budgetary savings, while having a relatively small impact on both current and future beneficiaries.

Opponents contend that the Social Security Amendments of 1983 have already sharply reduced the benefits of future retirees and that further reductions would be unfair. In particular, the age at which unreduced Social Security retirement benefits are first available will rise in stages from 65 to 67 for workers turning 62 between 2000 and 2022. As a consequence, benefits for workers retiring after the turn of the century will be less than what would have been received had the full retirement age not been increased. For example, a worker who retires at age 62 in 2022 will receive 70 percent of the primary insurance amount, compared with 80 percent for a worker who retired at age 62 in 1995.

An alternative method of reducing Social Security benefits would leave replacement rates unchanged but narrow the AIME brackets over which those rates apply, perhaps by reducing the pace at which the brackets are indexed for inflation. This approach would exempt beneficiaries with the lowest AIME from the cut, but would impose benefit reductions unevenly among other recipients.

ENT-60 LENGTHEN THE SOCIAL SECURITY BENEFIT COMPUTATION PERIOD BY THREE YEARS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Outlays	40	170	450	860	1,400	2,900

Social Security retirement benefits are based on the average indexed monthly earnings (AIME) of workers in jobs covered by the system. The present formula computes AIME based on workers' best 35 years of employment. Lengthening the averaging period would generally lower benefits slightly by requiring more years of lower earnings to be factored into the benefit computation. This option would increase the AIME computation period gradually until it reached 38 years for people turning 62 in 1998 or beyond. This approach would save $2.9 billion over the next five years and more in later years.

One argument for a longer computation period is that people are now living longer and the normal retirement age for the Social Security program will be raised beginning in 2000. In addition, lengthening the averaging period would reduce the advantage that workers who postpone entering the labor force have over those who get jobs at younger ages. Because many years of low or no earnings can be ignored in calculating AIME, the former group currently experiences little or no loss of benefits for its additional years spent not working and thus not paying Social Security taxes.

Because some beneficiaries elect early retirement for such reasons as poor health or unemployment, it is argued that this proposal would adversely affect recipients who are least able to continue working. Other workers who would be disproportionately affected include those with significant periods outside the Social Security system, such as parents--usually women--who interrupted their career to rear children and workers who experienced long periods of unemployment.

ENT-61 ELIMINATE SOCIAL SECURITY BENEFITS FOR CHILDREN OF RETIREES AGES 62-64

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Outlays	80	240	420	510	510	1,770

Unmarried children of retired workers are eligible for Social Security benefits as long as they are under age 18, or attend elementary or secondary school and are under age 19, or become disabled before age 22. A child's benefit is equal to one-half of the parent's basic benefit, subject to a dollar limit on the maximum amount receivable by any one family. If such benefits were eliminated for the children of retirees ages 62 through 64, beginning with retirees reaching 62 in October 1995, the savings would total $1.8 billion over the next five years.

This option might encourage some early retirees to stay in the labor force longer. At present, although benefits for retired workers and their spouses are actuarially reduced if retirement occurs before age 65, children's benefits are not. Further, the younger the workers are, the more likely they are to have children under 18. Thus, workers under 65 now have an incentive to retire while their children are still eligible for benefits, although this incentive is quite small for families in which spouses are also entitled to dependents' benefits. For these families, the increase in total benefits attributable to all eligible children cannot exceed 38 percent of the worker's primary insurance amount.

However, for families with workers whose retirement was not voluntary--because of poor health or unemployment, for example--the loss in family income might cause some hardship. Moreover, since spouses under 62 receive benefits only if their children under age 16 also receive benefits, eliminating children's benefits for families of early retirees would also result in the loss of entire benefits for spouses in some families. In such cases, the total loss of income would generally be large.

A different approach would apply the same actuarial reduction to children's benefits that is applied to the benefits of the worker on whom those benefits depend. Thus, for example, the child of a worker retiring at age 62 would receive a maximum of 40 percent of the parent's basic benefit, instead of the 50 percent that is currently allowed. Such an approach would avoid large losses in benefits for workers with young children, but would save less.

ENT-62 CONSIDER VETERANS' COMPENSATION WHEN DETERMINING SOCIAL SECURITY DISABILITY INCOME PAYMENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
	Coordinate Benefits for All Veterans Receiving Compensation					
Outlays	75	110	120	130	140	575
	Coordinate Benefits for Veterans Newly Awarded Compensation					
Outlays	10	20	30	45	55	160

People with disabilities may qualify for cash payments from more than one source, including the Social Security Disability Insurance (DI) program, veterans' compensation, workers' compensation, means-tested programs like the Supplemental Security Income program, and private disability insurance. If they are younger than 65 and covered under Social Security, workers who are unable to work because they are physically or mentally impaired may qualify for DI payments.

When Social Security beneficiaries are eligible for multiple disability benefits, ceiling arrangements limit combined public disability benefits to 80 percent of the workers' average earnings before they were disabled. The combined payment after the reduction is adjusted periodically for changes in the cost of living and in national average wage levels. Veterans' compensation payments for disabilities, however--as well as means-tested benefits and certain benefits based on public employment--are not included when applying the ceiling.

Approximately 2.2 million veterans--about 1.2 million of whom are under age 65--receive compensation for service-connected disabilities. The amount of compensation is based on a rating of an impairment's average effect on a person's ability to earn wages in civilian occupations. Additional allowances are paid to veterans whose disabilities are rated 30 percent or higher and who have dependent spouses, children, or parents. An estimated 125,000 veterans who receive compensation also receive DI payments from the Social Security program.

This option, which has two variations, would include veterans' compensation within the scope of the ceiling. (The combined payment, however, would never be less than either the DI benefit or the veterans' compensation payment.) Under both versions, compensation would be totaled when determining how much the DI benefit of an individual who is under 65 years old would be reduced to keep the combined benefit from exceeding the ceiling. One version of the option would apply this change to all current and future recipients of veterans' disability compensation. The other version would limit application of the option to veterans who newly qualify for disability compensation.

Applying the change to both current and future recipients of veterans' compensation would affect an estimated 30,000 recipients in 1996 and would save an estimated $575 million over the 1996-2000 period. Applying the change only to veterans who are newly awarded compensation payments would affect an estimated 15,000 recipients by 2000 and would save an estimated $160 million over the 1996-2000 period.

Putting these options into effect would mean that an explicit policy would determine the total amount

of public compensation for veterans who have service-connected disabilities. Thus, the federal government would treat in a more consistent way people who receive cash disability payments from multiple programs that are not means-tested. Both versions of the option could, however, be seen as subjecting veterans' compensation benefits to a form of income testing. Moreover, under the variation of this option that would apply to current recipients of disability compensation, the incomes of some disabled veterans would drop.

ENT-63 END VETERANS' COMPENSATION PAYMENTS FOR CERTAIN VETERANS WITH LOW-RATED DISABILITIES

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	660	679	690	703	716	3,447
Outlays	607	677	689	702	771	3,446

Approximately 2.2 million veterans who have service-connected disabilities receive veterans' disability compensation benefits. The amount of compensation is based on a rating of the individual's impairment that is intended to reflect an average reduction in the ability to earn wages in civilian occupations. Demonstrated loss of income, however, is not a requirement for eligibility. Veterans' disability ratings range from zero to 100 percent (most severe). Veterans unable to maintain gainful employment who have ratings of at least 60 percent are eligible to be paid at the 100 percent disability rate. Additional allowances are paid to veterans who have disabilities rated 30 percent or higher and who have dependent spouses, children, or parents. Receiving veterans' disability compensation does not affect the level of Social Security disability benefits to which an individual may be entitled (see ENT-62).

Currently, 1.3 million veterans have disability ratings below 30 percent and receive benefits of between $71 and $170 a month. Federal outlays could be reduced by $3.4 billion during the 1996-2000 period by ending disability benefits for low-rated disabilities, except for veterans with moderate or low family income. The income threshold used for this illustration is the median income of all families, which was about $37,000 in 1992. Thresholds that varied by family size might be a better measure of need, but the necessary information about the size of the families of the veterans who would be affected by this option was not available. (See ENT-68 for options to restrict eligibility for most non-means-tested entitlement programs, including veterans' compensation, on the basis of family income.)

Eliminating compensation benefits for veterans with disability allowances below 30 percent and relatively high family income would concentrate spending on the most impaired veterans. Because performance in civilian jobs depends less now on physical labor than when the disability ratings were originally set, and because improved reconstructive and rehabilitative techniques are now available, physical impairments rated below 30 percent may not reduce veterans' earnings. Low-rated disabilities include conditions such as mild arthritis, moderately flat feet, or amputation of part of a finger--conditions that would not affect the ability of veterans to work in many occupations today.

Veterans' compensation could be viewed, however, as career or lifetime indemnity payments owed to veterans disabled to any degree while serving in the armed forces, regardless of family income. Moreover, some disabled veterans--especially older ones who have retired--might find it difficult to increase their working hours or otherwise make up the loss in compensation payments.

ENT-64 END VETERANS' DISABILITY AND DEATH COMPENSATION AWARDS IN FUTURE CASES WHEN A DISABILITY IS UNRELATED TO MILITARY DUTIES

Savings from Current-Law Spending	Annual Savings (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
Budget Authority	21	89	197	323	465	1,095
Outlays	19	81	184	309	500	1,093

Veterans are eligible for disability compensation if they either receive or aggravate disabilities during active military service. Service-connected disabilities are currently defined as those resulting from diseases, injuries, or other physical or mental impairments that occurred or were intensified during military service, excluding those resulting from willful misconduct. Disabilities need not be incurred or made worse while performing military duties to be considered service-connected; for example, disabilities incurred while on leave also qualify. The federal government gives death compensation awards to survivors when a service-connected disability is related to the cause of death.

As many as 50 percent of veterans receiving compensation payments may be receiving compensation for injuries or diseases not related to the performance of military duties. Ending disability and death compensation awards in future cases in which a disability is neither incurred nor aggravated while performing military duties would reduce outlays by more than $1 billion. Approximately 5 percent of these savings would come from reduced death compensation awards.

This option would make disability compensation of military personnel comparable with disability compensation of federal civilian employees under workers' compensation arrangements. Because military personnel are assigned to places where situations may sometimes be volatile, however, they have less control than civilians over where they spend their off-duty hours. Therefore, in many cases it might be difficult to determine whether a veteran's disease, injury, or impairment was entirely unrelated to military duties. The formal appeals system of the Department of Veterans Affairs (VA) could be extended to cover rulings specifying that disabling conditions were unrelated to military duties.

Data collected by the VA indicate that about 230,000 veterans currently receive VA compensation payments totaling $1.5 billion a year for diseases that the General Accounting Office (GAO) reports are generally neither caused nor aggravated by military service. The diseases include arteriosclerotic heart disease, diabetes mellitus, multiple sclerosis, Hodgkins disease, chronic obstructive pulmonary disease (including chronic bronchitis and pulmonary emphysema), hemorrhoids, schizophrenia, osteoarthritis, and benign prostatic hypertrophy. Ending new awards for veterans with those diseases would have a more limited impact than this option because it would not affect all veterans whose compensable disabilities are not connected with military service. It could, however, eliminate compensation for some veterans whose disabilities the GAO finds are not generally service-connected but whose circumstances constitute an exception from this general conclusion. That approach would yield smaller savings than the previous measure--about $634 million over the 1996-2000 period.

ENT-65 ELIMINATE "SUNSET" DATES ON CERTAIN PROVISIONS FOR VETERANS IN THE OMNIBUS BUDGET RECONCILIATION ACT OF 1993

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
			Reduce Pensions to Medicaid Nursing Home Residents			
Budget Authority	0	0	0	199	206	405
Outlays	0	0	0	198	246	439
			Verify Income Reported for Pension Purposes			
Budget Authority	0	0	0	5	15	20
Outlays	0	0	0	5	15	20
			Recover Certain Medical Care Costs for Veterans from Third Parties			
Budget Authority	0	0	0	211	222	433
Outlays	0	0	0	211	222	433
			Impose Copayments for VA Medical Care			
Budget Authority	0	0	0	31	32	63
Outlays	0	0	0	31	32	63
			Eliminate All Sunset Dates			
Budget Authority	0	0	0	446	475	921
Outlays	0	0	0	445	515	960

Four provisions in law that affect veterans will cease to apply on September 30, 1998--their "sunset" date. As a result, starting in 1999, outlays will be higher than if the provisions remained in effect. These provisions have:

- Protected the monthly benefit for certain pensioners without dependents who are eligible for Medicaid coverage for nursing home care, thus saving the Department of Veterans Affairs (VA) pension costs but increasing costs for the Medicaid program, which is paid for by the federal and state governments.

- Authorized the Internal Revenue Service to help the VA verify incomes reported by beneficiaries, for the purpose of establishing eligibility for pensions and benefits.

- Authorized the VA to collect from any health insurer that contracts to insure a veteran with service-connected disabilities the reasonable cost of medical care provided by the VA for the treatment of non-service-connected disabilities.

- Authorized the VA to charge copayments to certain veterans receiving inpatient and outpatient care and outpatient medication from agency facilities.

This option would make the effects of these provisions permanent by eliminating the sunset date in

each case. If all four provisions were made permanent, savings from current-law spending during the 1996-2000 period would total almost $1 billion.

The main advantage of this option is that it would convert the temporary savings achieved by these provisions into continuing savings. The main disadvantage of the option is that certain veterans or their insurers would be worse off financially. States would also face higher Medicaid costs because of withdrawn federal funds for nursing home care.

ENT-66 IMPOSE A COST-OF-CAPITAL OFFSET FEE ON FANNIE MAE AND FREDDIE MAC

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	700	700	700	700	700	3,500
Outlays	700	700	700	700	700	3,500

The interest rate that a firm must pay to borrow money depends on its credit rating. Greater financial strength in a borrower implies a higher level of credit quality (that is, less risk to the lender) and generally lowers the interest and other costs that borrowers must pay to obtain funds. But financial strength--especially when it is based on large amounts of shareholder-provided equity--comes at a price: shareholders must be compensated for the use of their money, which is tied up in raising the credit rating of the company.

The federal government helps government-sponsored enterprises (GSEs) reduce the cost of money from all sources by putting what is essentially the government's seal of approval on the GSEs' financial obligations. (A GSE is an enterprise that is established and chartered by the government for a specific financial purpose but is wholly owned by private stockholders.) That seal of approval consists of several provisions of law, including one that exempts the GSEs from many federal and state regulations designed to protect investors. Through such laws, the federal government sends a signal to investors that securities issued by a GSE are less risky than the GSE's financial condition would suggest. In other words, the federal government is a "shadow" provider of equity capital to the GSE: it stands in for other investors whose capital would be required in the government's absence to bolster the GSE's credit rating, and who would demand compensation for the use of their money.

As a consequence of the federal "presence," GSEs are able to obtain funds in the capital markets at lower interest rates than those paid by fully private borrowers of comparable financial condition. Although estimates are uncertain, two of the GSEs, the Federal National Mortgage Association (FNMA, or Fannie Mae) and the Federal Home Loan Mortgage Corporation (FHLMC, or Freddie Mac), probably save more than 30 cents (30 basis points) every year on every $100 of long-term debt they have because of their affiliation with the federal government. On mortgage-backed securities issued and guaranteed by the two GSEs, the cost advantage is smaller; nevertheless, it probably exceeds 5 cents (5 basis points) for every $100 of securities outstanding each year. Although those amounts might seem to be a small benefit, they add up to over $1.5 billion per year because Freddie Mac and Fannie Mae have over $1 trillion in outstanding securities. GSEs do not pay the government a fee or any other compensation for the reduced cost of capital they enjoy as a result of their status as sponsored enterprises.

More than 20 years ago, the federal government chartered Freddie Mac and Fannie Mae to give local, retail mortgage lenders a conduit to the vast sums of money available in the bond markets. In doing so, the government hoped to avoid periodic credit shortages for home buyers. Federal policy to give mortgage lenders access to Wall Street through Fannie Mae and Freddie Mac has clearly succeeded. In successfully channeling money from investors to home buyers and back to investors, the housing GSEs have demonstrated the profitability of such activity. As a consequence, credit is now reliably available to home buyers at all times. But an unfortunate side effect has been that the two GSEs now virtually monopolize the resale, or "secondary," market for fixed-rate home mortgages. In 1993, the volume of mortgages purchased by Fannie Mae and Freddie Mac exceeded one-half of all single-family mortgages that were

originated. The GSEs dominate the market in part because the federal government's seal of approval helps reduce the cost of their borrowing.

An offset fee equal to one-half of the savings in capital costs that Freddie Mac and Fannie Mae derive from federal affiliation would be a step toward more equitable competition. In addition, it would compensate taxpayers for the value of the capital services that the government provides. Because of the differential effect of federal affiliation, separate fees should be applied to the GSEs' debt and to mortgage-backed securities (MBSs). (Such securities essentially give their buyers rights to share in the future stream of income generated by a large pool of mortgages put together by the GSE.) One-half of the estimated 30-basis-point saving on debt and one-half of the 5 basis-point-saving on MBSs imply a fee schedule of 15 and 2.5 basis points on the average amount of debt and of MBSs, respectively, that are outstanding each year. Outstanding debt and MBSs for the two GSEs currently stand at about $1.3 trillion ($300 billion of debt and $1 trillion of MBSs). Under the fee schedule proposed in this option, in 1994 federal revenues would have increased by about $700 million based on the GSEs' currently outstanding obligations.

Initially, the fee would reduce the GSEs' earnings, which are projected to total about $3 billion this year. The fee could also raise interest rates on mortgages that have a face value of $203,150 or less and that are eligible for purchase by Freddie Mac or Fannie Mae. If the GSEs were unable to shift any of the cost of the fee to others, their return on their shareholders' investments would fall by about one-fourth--Fannie Mae's from a projected 24 percent and Freddie Mac's from a projected 20 percent. But two effects would be likely to dampen the consequences of the fee for the GSEs' earnings. First, Freddie Mac and Fannie Mae would pass the fee on to others by charging higher interest rates on new mortgage purchases and higher fees on new MBSs. Second, both entities would be likely to shift their funding toward MBSs and away from debt securities, thus lowering the amount of fees they would have to pay. If the entire fee was passed on, home buyers could face interest rates that were up to 0.1 percentage point higher.

The fee discussed here has characteristics of both a user fee and a tax. That ambiguity makes it unclear whether the proceeds should be shown on the revenue side of the budget as governmental receipts or on the spending side as offsetting collections. On balance, however, the charge seems more closely to resemble a fee for services than a tax. Accordingly, this option credits collections from the fee to a Treasury account as offsetting receipts, which are paid into the general fund. That same treatment has been applied to such fees proposed in the budget requests of previous Presidents.

Several federal agencies, including the Congressional Budget Office, are now studying the feasibility and desirability of restructuring Freddie Mac and Fannie Mae into fully private firms. If the Congress decided to sever the federal government's links to these GSEs and revoke its "seal of approval," the cost-of-capital offset fee would need to be repealed.

ENT-67 RESTRICT COST-OF-LIVING ADJUSTMENTS IN NON-MEANS-TESTED BENEFIT PROGRAMS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Eliminate COLAs for One Year						
Social Security/ Railroad Retirement	8,010	10,900	11,100	11,180	11,220	52,410
Other Non-Means-Tested Programs	970	2,550	2,580	2,650	2,770	11,520
Offsets in Means-Tested Programs and Medicare Premiums	-280	-380	-400	-410	-420	-1,890
Total	8,700	13,070	13,280	13,420	13,570	62,040
Limit COLAs to Two-Thirds of the CPI Increase for Five Years						
Social Security/ Railroad Retirement	2,670	6,670	11,010	15,550	20,300	56,200
Other Non-Means-Tested Programs	190	830	1,440	2,310	3,050	7,820
Offsets in Means-Tested Programs and Medicare Premiums	-100	-300	-540	-1,100	-1,940	-3,980
Total	2,760	7,200	11,910	16,760	21,410	60,040
Limit COLAs to the CPI Increase Minus 0.5 Percentage Points for Five Years						
Social Security/ Railroad Retirement	1,290	3,110	5,040	7,080	9,220	25,740
Other Non-Means-Tested Programs	170	660	1,110	1,710	2,260	5,910
Offsets in Means-Tested Programs and Medicare Premiums	-50	-110	-190	-380	-630	-1,360
Total	1,410	3,660	5,960	8,410	10,850	30,290
Pay the Full COLA on Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level for Five Years						
Social Security/ Railroad Retirement	0	1,230	2,920	4,680	6,480	15,300

Under current policies, outlays for Social Security and other non-means-tested cash transfer programs whose benefits are indexed to the consumer price index (CPI) are expected to total $430 billion in 1996 and to rise to $540 billion by 2000. Reducing the automatic cost-of-living adjustment (COLA) for these programs is commonly proposed as one way to slow the growth in entitlement spending. Four strategies for reducing COLAs and the savings in outlays resulting from each are shown in the preceding table. The programs in which COLAs would be reduced under the first three options are Social Security Old-Age, Survivors, and Disability Insurance; Railroad Retirement; Civil Service Retirement; Military Retirement; workers' compensation for federal employees; veterans' compensation; and retirement benefits for the Foreign Service, the Public Health Service, and the Coast Guard. The fourth option would affect only Social Security and Railroad Retirement Tier I COLAs. (Other options for achieving savings in Social Security are given in ENT-59 through ENT-62 and REV-15.)

COLA restrictions would achieve considerable savings by exacting small reductions in benefits from a large number of people, in contrast to other budget options that would impose large reductions in benefits on smaller groups of recipients. Moreover, limiting these options to the non-means-tested cash benefit programs would protect many of the poorest beneficiaries of entitlements--for example, recipients of Supplemental Security Income--from losses of income. Finally, because the benefit levels would be permanently lowered for those eligible when the COLA limitation was established, significant reductions in outlays would persist beyond the five-year projection period. The savings would eventually disappear, however, as beneficiaries died or stopped receiving payments for other reasons, unless the COLA limitation was accompanied by a permanent reduction in the initial benefits of newly eligible workers (see ENT-59).

Another argument in favor of less-than-complete price indexing is that the CPI probably overstates increases in the cost of living for the population as a whole. Although the amount of bias is not known, the existing empirical evidence indicates that recently the CPI has probably grown faster than the cost of living by between one-fifth and four-fifths of a percentage point a year. The magnitude of the bias--and even its direction--is less clear when the CPI is used as a measure of increases in the cost of living for the recipients whose benefits are indexed. (This evidence is reviewed in an October 1994 Congressional Budget Office paper, *Is the Growth of the CPI a Biased Measure of Changes in the Cost of Living?*) The Bureau of Labor Statistics, the agency that produces the CPI, continues to examine ways of improving the index. Because of the uncertainty about the magnitude of the bias, reductions in automatic COLAs for this reason might be premature.

Budget reduction strategies that institute less-than-complete price indexing would also result in financial difficulties for some recipients--particularly if COLAs were restricted for an extended period. Restrictions on COLAs also encounter opposition from those who fear that changes made to reduce budget deficits would undermine the entire structure of retirement income policy. For example, because private pension plans generally do not offer complete indexing, restricting Social Security COLAs would further reduce protection for beneficiaries against inflation. Some people also think that, because Social Security and other retirement programs represent long-term commitments to both current retirees and today's workers, these programs should be altered only gradually and then only for programmatic reasons. According to this view, any changes in benefits should be announced well in advance to allow people to adjust their long-range plans.

Unless restrictions on COLAs were accompanied by commensurate changes in determining initial benefits for new recipients, disparities in benefit levels would develop among different cohorts of retirees. This situation is particularly relevant for Social Security, in which benefits for newly eligible individuals are based on an indexed benefit formula and on indexed earnings histories. For example, if prices rose by 4 percent in a year and the wage index used to compute benefits for newly eligible recipients increased by 5 percent, the act of eliminating that year's COLA without changing the calculation of initial benefits would produce benefits for new beneficiaries that were about 5 percent higher than for recent retirees; under current law, benefits would be only about 1 percent higher for the new retirees. To alleviate this problem and to achieve additional savings, ef-

forts to slow the growth in benefits through COLA limitations might be extended to the formulas for determining initial benefits (see ENT-59).

There are several options to restrict COLAs for current beneficiaries. Except for the option to limit COLAs to 2 percentage points less than the increase in the CPI, the magnitude of the savings in each case --as well as the impact on beneficiaries--would be very sensitive to the level of inflation in the years in which the COLAs would be reduced. If prices were to rise faster than currently assumed, savings would be greater than shown, and recipients would bear larger costs. If prices were to rise less quickly, both budgetary savings and the effect on recipients would be smaller.

The following are specific versions of COLA restrictions:

Eliminate COLAs for One Year. One option would be to eliminate COLAs in 1996 for non-means-tested benefit programs and allow them to be paid in subsequent years, but with no provision for making up the lost adjustment. If this approach was taken, federal outlays would be reduced by about $8.7 billion in 1996 and $62.0 billion over five years, with Social Security and Railroad Retirement accounting for most of the total.

Limit COLAs to Two-Thirds of the CPI Increase for Five Years. Under this approach, recipients would be compensated for only a certain proportion of inflation, such as two-thirds of the annual CPI increase. Under current economic assumptions by the Congressional Budget Office, applying this restriction for five years would save about $2.8 billion next year and $60 billion over the 1996-2000 period. As a result, benefits for people who received payments throughout the five-year period would be about 4 percent less in 2000 than they would have been under full price indexing. Furthermore, this option would reduce the real income of beneficiaries at the same time that they were becoming less able to supplement their income by working.

Limit COLAs to the CPI Increase Minus 0.5 Percentage Points for Five Years. An approach similar to the proportionate COLA reduction would be to reduce the adjustment by a fixed number of percentage points; for example, set the adjustment at the CPI increase minus 0.5 percentage points. Unlike other options to restrict COLAs, however, both savings and effects on beneficiaries would be roughly the same regardless of the level of inflation--about $30 billion over the next five years, if extended for the full period.

Pay the Full COLA on Benefits Below a Certain Level and 50 Percent of the COLA on Benefits Exceeding That Level for Five Years. Another alternative would tie the COLA reductions to beneficiaries' payment levels, starting in 1997. The example discussed here--based only on Social Security and Railroad Retirement Tier I benefits--would award the full COLA for benefits based on the first $650 of a retiree's monthly primary insurance amount (PIA) and 50 percent of the COLA on benefits above that level. The $650 per month threshold is about equal to the projected 1997 poverty level for an elderly person and would be indexed to maintain its value over time.

This approach would save about $1.2 billion in 1997 and $15.3 billion over the 1997-2000 period. Because of the time needed to carry out this proposal, these estimates assume that it would be in place by January 1997.

Because the full COLA would be paid to beneficiaries with low PIAs, this option would ensure that low-income recipients were not adversely affected. Moreover, its percentage impact would be greater for recipients with higher benefits. Nonetheless, benefit levels are not always good indicators of total income. Some families with high benefits have little other income, while some with low benefits have substantial income from other sources. Furthermore, many people object to any changes in retirement programs that might be construed as introducing a means test for benefits, even if the test is limited only to the COLA.

A variation would extend this approach to the other non-means-tested benefit programs besides Social Security; this variation is not shown in the table. Such an option would spread the effects among a wider group of recipients, although it might be somewhat more complicated to design because the different benefit structure in each program could require a

separate determination of the appropriate benefit levels on which to pay reduced COLAs.

Eliminating COLAs for recipients whose benefits are based on PIAs above a certain level is another option. Because this reduction would affect the entire benefit of each recipient above the threshold, not just the portion of the benefit above that level, both the savings and the impacts on beneficiaries would be considerably greater. Unless adjustments were made at the threshold, however, recipients with benefits just below the threshold could be made better off than those with benefits just above it. Still another approach that would address some of the administrative problems of these two options would involve increased taxation of Social Security benefits (see REV-15).

ENT-68 APPLY MEANS TESTS TO FEDERAL ENTITLEMENTS

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
			Make Entitlements Subject to Individual Income Tax			
Non-Means-Tested Entitlements	16,000	46,200	49,500	53,200	57,200	222,100
All Entitlements	18,600	55,100	59,600	64,600	70,000	267,900
			Reduce Entitlements Provided to Middle- and High-Income Families			
Non-Means-Tested Entitlements	10,100	47,800	45,000	48,600	52,400	203,900
All Entitlements	10,100	50,900	48,400	52,400	56,700	218,500
			Deny Entitlements to High-Income Recipients			
Non-Means-Tested Entitlements	4,300	10,400	9,600	10,300	11,100	45,700
All Entitlements	4,300	10,400	9,700	10,500	11,400	46,300

SOURCE: Congressional Budget Office.

NOTE: Estimates do not include administrative costs or revenue losses from reductions in taxable benefits.

There are two basic approaches to constraining entitlement spending. One broad strategy would reduce the growth of spending (or tax the benefits at higher rates) on a program-by-program basis. New program rules or tax laws could limit who qualifies for benefits, reduce the amount of benefits provided, or change the taxation of benefits. (Examples of this kind of approach include ENT-48, ENT-49, ENT-60, ENT-63, ENT-67, REV-15, and REV-17.)

An alternative to the program-by-program approach would constrain entitlements as a group through some form of means-testing under which benefits would be cut most for beneficiaries with the highest income. Three illustrations of that method are discussed here. The first approach would subject most entitlement benefits to federal individual income taxes, the second would reduce benefits as beneficiaries' income rises, and the third would deny benefits to individuals with income above specified thresholds. The savings attributed to those three approaches would be smaller than shown here if the Congress enacted one or more of the program-by-program approaches described in other options.

Some federal entitlements are already subject to limits on income or wealth under program regulations. The federal part of Supplemental Security Income (SSI) is available only to elderly and disabled people with monthly income below federally specified national limits. Aid to Families with Dependent Children (AFDC) goes only to families with children who have monthly income below limits set by individual states. Recipients of SSI and AFDC are automatically eligible for Medicaid, as are certain people with low family income. Only households with

monthly income below the federal poverty guidelines qualify for food stamps. Because those and other means-tested programs currently provide benefits only to people with low monthly income, subjecting them to any of the three methods of means-testing discussed here would duplicate the current means-testing at significantly higher income levels, imposing administrative and compliance costs and having little effect on net saving. At the same time, because each of the alternative approaches would impose an annual means test--as opposed to the monthly tests now used in each program--beneficiaries who qualify for assistance for only part of a year could lose some or all of their benefits. Budgetary savings for each approach are shown both including and excluding those transfers that are already means-tested.

Non-means-tested entitlement programs included here are Social Security and Railroad Retirement, Medicare, unemployment compensation, and veterans' benefits. Since Social Security and Medicare account for the bulk of entitlements, the options discussed here largely affect the elderly. The analysis excludes two other major entitlement programs--federal civilian and military pensions--because they are part of the labor contract between the government and its employees and not transfers in the same sense that the included programs are. Several options to constrain spending on these two excluded programs are discussed in ENT-50.

Means-testing could be based on individual income, income of couples, or the income of a more broadly defined family. The unit used determines which recipients would be affected by the alternative approaches, as well as how recipients might respond to means-testing. Because families generally consume as a unit, family income and wealth are probably better measures of need than individual income and wealth. Further, the family measures are greater than the individual measures, so applying the same dollar thresholds in means tests to families rather than individuals would affect more recipients. At the same time, depending on how the means tests are structured, basing the tests on families could induce families to split up into smaller units to minimize benefit reductions. For example, in the approach to benefit reduction discussed below, a retired couple in which each spouse had $20,000 of pension and investment income and $10,000 of Social Security would lose $3,000 of their Social Security benefits; if they divorced, they would keep all of their benefits. Appropriate differentiation of benefit reductions for individuals and families of different sizes could reduce or remove such incentives for family breakup.

A significant objection to global means-testing of entitlements is that different programs serve different purposes. Individual programs provide people with separate types of in-kind consumption, such as food, housing, and medical care. Society may wish to ensure fuller access to those goods and services rather than simply provide more cash income. In that view, any limit on benefits should be imposed on a program-by-program basis to allow different criteria to be applied.

Reducing entitlements to medical assistance raises special concerns. One problem is valuing medical services in dollar terms. One approach would base value on benefits actually received. That approach could yield unacceptable results because it would assign the highest values to the sickest people receiving the most care. Another approach would count the federal subsidy to in-kind programs as benefits. In Medicare, for example, the subsidy would be the implicit value of an insurance premium paid for by the government.

Means-testing benefits also poses a transitional problem, particularly for retirees. Recipients of benefits may have made financial decisions and plans expecting particular incomes from entitlements. Changing those benefits could impose hardships. Phasing in taxation of benefits or means tests over time would mitigate that difficulty.

Make All Entitlements Subject to Individual Income Tax. Under current law, some benefits of federal entitlement programs, such as unemployment compensation and military pensions, are fully subject to individual income taxes; others, such as Social Security, are partially so; and still others, such as Medicare and food stamps, are entirely excluded from taxable income. One approach to means-testing all entitlements would include in taxable income all federal entitlement benefits in excess of contributions made for specific programs. Thus, for example, the insurance value of Medicare in excess of premiums paid for Supplementary Medical Insurance coverage

would become part of a recipient's taxable income. Program administrators would tell recipients annually the net value of benefits to report as taxable income, using a form 1099-G similar to the forms used to report dividend and interest income. Such inclusion for all entitlements would increase revenues by about $18.6 billion in 1996 and $267.9 billion from 1996 through 2000.

Taxing entitlements recognizes that entitlements increase a recipient's ability to pay taxes in the same way that other forms of income do. Excluding some entitlement payments from taxable income simply because they come from the government could be viewed as violating the principle that taxes should be higher for people with higher income. A counterargument, however, asserts that entitlements are not taxable now simply because benefit levels are set to be net of taxes. If those levels are too high, the Congress should reduce them within each individual program. Making benefits taxable does have the advantage of providing a straightforward annual measure of recipients' needs for federal assistance. Even so, it could be difficult to justify including noncash benefits received from the government, but not those provided by employers. That last objection is not an issue, however, if taxing benefits is viewed as a means of allocating scarce government resources to the most needy recipients.

Reduce Benefits Provided to Middle- and High-Income Families. The Concord Coalition has proposed that federal entitlement benefits be reduced rapidly as income rises. Benefit reduction could be achieved either through supernormal tax rates imposed under the individual income tax or directly through new programmatic structures. Under the Concord Coalition's proposal, families with income above $40,000 would lose benefits under a graduated scale beginning at 10 percent for those with income between $40,000 and $50,000 and increasing by 10 percentage points for each $10,000 of income up to 85 percent of benefits above $120,000 of total income. Nontransfer income would be considered first in determining the rate of benefit reduction, and benefits would be reduced only to the extent that they caused total income to exceed $40,000. For example, a family receiving $15,000 of Social Security and $30,000 of nontransfer income would lose $500 of benefits--10 percent of the $5,000 by which total income exceeds $40,000. If the family had $45,000 of nontransfer income, it would lose $2,500 of its Social Security--10 percent of the $5,000 that falls in the $40,000 to $50,000 income range and 20 percent of the $10,000 that falls in the $50,000 to $60,000 income range. A family with nontransfer income above $120,000 would have its benefits reduced by 85 percent. (Under the Coalition's plan, married couples and larger families would face the same income limits as single people, and all dollar values would be indexed for inflation.)

This option would reduce benefits for all entitlements by about $10 billion in 1996 and about $219 billion from 1996 through 2000. Compared with the option that would tax benefits, this proposal to reduce benefits would have no effect on families with lower income and a greater effect on families with higher income.

This approach reflects the view that entitlements should go primarily to those most in need of them, not to families with higher income. Imposing the same criteria for establishing need among all entitlement programs might be the fairest way to limit benefit payments. A global approach to benefit reduction could also be less costly to administer than an approach that addresses each program individually, although whether it would cost less depends in large part on whether new administrative apparatuses would have to be created.

A significant problem with this option is the disincentive for families to save and earn other income that is created by the rapid reduction in benefits as income rises. That effect would be mitigated somewhat, however, if the benefit reduction was phased in gradually over a wide income range. Recipients with income well above the $120,000 level at which benefit reduction is greatest would face smaller or no disincentives, since they would have to lower their income greatly to incur a smaller benefit reduction. An alternative to forgoing income to lessen benefit reductions would be to shift income to sources that would not be counted in the benefit reduction formula. For example, if interest on tax-exempt bonds was not counted, entitlement recipients would be expected to shift their investments into

those bonds. Such behavior could be limited, however, by counting as many forms of income as possible in determining benefit reductions.

Deny Entitlements to High-Income Recipients. Some Members of Congress have recently considered a third approach to means-testing entitlements that would deny completely any entitlement payments to recipients with income above specific limits. The budgetary savings shown assume limits of \$100,000 for single recipients and \$120,000 for married couples, with benefits phasing out over a \$10,000 income range. This option would reduce spending on all entitlements by \$4.3 billion in 1996 and \$46.3 billion over a five-year period. Compared with the proposal of the Concord Coalition to reduce benefits, this option would exempt middle-income families from benefit cuts and impose larger benefit reductions on families with the highest income.

This approach has many of the advantages of and problems faced by the alternative that would simply reduce benefits. Because benefits would be phased out over a narrow income band, however, the work and saving disincentives would be significantly greater for people with income near the cutoff level. Families with more than \$10,000 in benefits and income in the phaseout range would face marginal tax rates of more than 100 percent from this provision alone. The narrower the band, the more likely would be potential recipients with income in or just above the phaseout range to adjust the timing of their income receipts, forgo savings, or reduce work effort to stay under the income limit. At the same time, because beneficiaries with income below the phaseout range would continue to receive full benefits, many fewer recipients would face work and saving disincentives than in the approach that would reduce benefits over a broad income range. Any reduction in work effort or savings would reduce the budgetary savings. Finally, this approach would also create incentives to shift income to sources excluded from the income calculation.

ENT-69 CHARGE FEDERAL EMPLOYEES COMMERCIAL RATES FOR PARKING

Savings from Current-Law Spending	Annual Savings (Millions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Savings
Budget Authority	100	110	110	110	110	540
Outlays	100	110	110	110	110	540

The federal government leases and owns more than 200,000 parking spaces, which it allocates to its employees--in most cases, without charge. Requiring employees of the federal government to pay commercial rates for their parking could reduce the deficit by $540 million through 2000.

The vast majority of federal workers park without charge. For example, one survey of 10 agencies in Washington, D.C., found that 71 percent of federal workers who received parking from their agencies received it free of charge. Employees of the Congress also received free employer-provided parking. Federal workers who pay for parking are almost always charged less than the commercial rate, although federal agencies, with the approval of the General Services Administration, are allowed to charge their employees the higher commercial fees. Some Members of Congress support charging all federal employees parking fees set at commercial rates, an idea similar to a proposal made by President Carter. The Clinton Administration has also proposed greater incentives for agencies to charge higher rates for parking spaces.

Federal workers in the largest metropolitan areas would bear the brunt of these new charges. Those in the Washington, D.C., metropolitan area would be affected most, paying about 75 percent of the total charges. Federal employees in less commercially developed areas--where charging for parking is uncommon--would not face new fees. The estimated savings rely on the best available information about the number of federal parking spaces, commercial parking rates, and expected declines in the demand for parking by federal workers as a result of higher rates. Once commercial rates were instituted, however, future parking rates, the number of spaces controlled by the federal government, and responses by federal workers could vary unexpectedly.

In 1992, the Congress passed an energy policy law that contained a provision to include as taxable income the commercial value of any parking provided free of charge by an employer--including the federal government--in excess of $155 per month (indexed for inflation beyond 1993). Paying for parking at commercial rates would reduce the gross income of such employees; however, the estimate of savings from this option does not include the reduction in tax revenues that would result, because available data do not allow an estimate of the option's effect on revenues. Analysts agree, however, that the offsetting reduction in revenues would be relatively small.

Proponents of charging commercial rates for employer-provided parking argue that subsidized parking increases the frequency with which workers drive to work, especially in single-occupancy vehicles. Those observers believe that higher prices for parking would decrease the flow of cars into urban areas by encouraging the use of public transportation or car pooling. In turn, they argue, a reduction in the number of cars would reduce energy consumption, air pollution, and congestion.

Some supporters of charging fees also maintain that the federal government would be acting as a model employer and could call more effectively on others to reduce pollution and energy consumption. In addition, charging commercial prices for parking would show more accurately the demand for parking by federal workers. At commercial rates, the supply of employer-provided parking may well exceed demand, which could lead to alternative uses of current

parking space. Moreover, commercial pricing would allocate spaces to those who valued them the most, thereby setting aside differences in income. Finally, some observers argue that the federal government can no longer afford to provide valuable goods and services free of charge to workers who can afford to pay for them.

Opponents of full-cost pricing for parking argue that it would unfairly penalize workers in urban areas who have difficulty obtaining access to alternative transportation or who drive to work for valid personal reasons. In the view of those critics, charging commercial rates for parking for federal workers effectively represents a cut in total compensation and is inappropriate, given other proposed reductions in federal employment and compensation. Some critics have also argued that free parking is a common form of compensation in the private sector. (However, in the Washington, D.C., metropolitan area, only 37 percent of parking spaces for private-sector workers were provided free of charge in 1991; 46 percent were priced at the full commercial rates.) In addition, some people argue that the new charge will simply change the mix of federal employees using the parking spaces--higher-income employees will be favored over lower-income ones. Now, the allocation of parking spaces in many agencies is based on rank, seniority, or other factors; instituting fees for parking would ration spaces to employees who were willing to pay commercial rates.

If the funds collected from charging commercial rates for parking were used to finance other spending, the savings noted earlier in this option would be smaller or zero. The Administration, for example, has supported new incentives for agencies to charge higher rates for parking in order to subsidize the use of mass transit by their workers. That proposal would neither reduce nor enlarge the deficit because agencies would not rebate the fees to the Treasury but instead provide them to transit-using employees. The funds raised by this option would be counted as offsetting collections or offsetting receipts, depending on how the option was applied.

ENT-70 MAKE PERMANENT VARIOUS EXPIRING USER FEES INCLUDED IN THE OMNIBUS BUDGET RECONCILIATION ACTS OF 1990 AND 1993

Addition to Current-Law Receipts	Annual Added Receipts (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Patent and Trademark Fees	0	0	0	119	119	238
Vessel Tonnage Charges	0	0	0	49	49	98
Rail Safety Fees	42	43	45	47	49	226

The Omnibus Budget Reconciliation Acts of 1990 and 1993 (OBRA-90 and OBRA-93) included provisions creating user fees for a variety of services that the federal government provides to private parties. OBRA-90 enacted rail safety fees for the years 1991 through 1995. OBRA-93 levied fees on vessel tonnage and imposed patent and trademark fees that will expire in 1998. Extending these fees could raise $562 million in receipts for 1996 through 2000, providing offsetting receipts in the budget functions designated for commerce and transportation.

The general argument for user fees applies to each of the proposals included in this option; namely, that the recipients of government services should bear the cost of those that clearly benefit a specific group. Accordingly, patent and trademark fees are established to cover the cost of providing services to would-be holders of a patent or trademark. The vessel tonnage fee is collected on all vessels entering a U.S. port and helps support the general operations of the Coast Guard. The fees charged railways offset the cost of the government's railway safety activity.

Antithetically, it can be argued that services provided by government ultimately benefit the general populace and should be paid for by all taxpayers rather than a specific group. Those who advocate the repeal of specific fees argue that charges were unevenly applied among users or, directly or indirectly, inflicted undue costs on payers.

Chapter Five

Revenues

The start of a new Congress provides an opportunity to reexamine how the federal government goes about raising revenue. Although the Congress is currently interested in tax reductions and tax reforms, the objective of reaching a balanced budget by 2002 could force consideration of revenue-raising measures as part of those reforms. This chapter presents 39 revenue-raising options that would affect taxpayers at all income levels and include all of the major revenue sources.

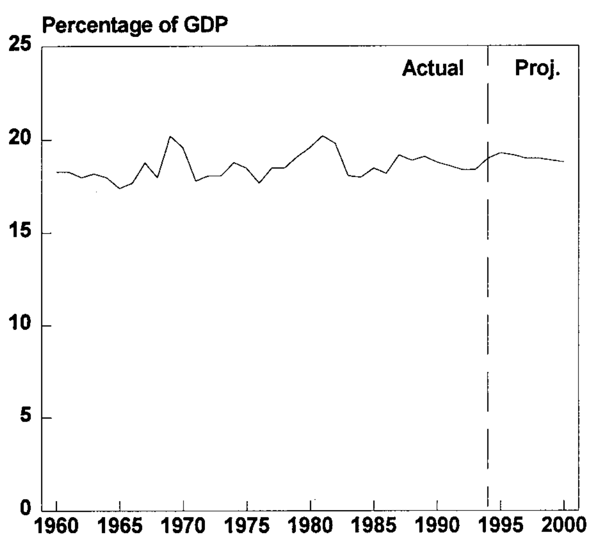
Federal revenues were $1.26 trillion in 1994 (see Table 5-1). With no change in current policies governing taxes, nominal revenues will grow to $1.36 trillion in 1995 and $1.7 trillion by 2000.

Currently, about 90 percent of federal revenue comes from income and payroll taxes. In 1994, the individual income tax raised 43 percent of federal revenue, the payroll tax 37 percent, and the corporate income tax 11 percent. Excise taxes raised an additional 4 percent of federal revenue. The rest came from estate and gift taxes, customs duties, and fees and other miscellaneous receipts.

Federal revenues in 1994 claimed 19 percent of gross domestic product (GDP). If the Congress enacts no new legislation affecting revenues, the Congressional Budget Office expects the revenue share of GDP to average 19 percent over the next six years.

Since 1960, the revenue share of GDP has dropped as low as 17.4 percent and risen as high as 20.2 percent, with an average value of 18.6 percent (see Figure 5-1). The revenue share surpassed 20 percent in the late 1960s when the Congress enacted an income tax surcharge during the Vietnam War, and again in 1981 after several years of rapid inflation pushed taxpayers' incomes into higher tax brackets ("bracket creep"). Large personal and corporate tax reductions enacted in the Economic Recovery Tax Act of 1981 (ERTA), combined with back-to-back recessions in 1980 and 1981-1982, brought the revenue share down to about 18 percent in 1983. ERTA also removed inflationary bracket creep from the personal income tax by enacting--starting in 1985--indexing for inflation of the personal income tax bracket amounts, the standard deduction, and the personal exemption. In subsequent years, the revenue share of GDP, bolstered by sustained economic growth and deficit reduction measures, climbed to

Figure 5-1.
Total Revenue as a Share of GDP



SOURCE: Congressional Budget Office.

19.1 percent in 1989. As a result of the 1990-1991 recession and the slow recovery that followed, the revenue share fell to 18.4 percent in 1992 and 1993 before rebounding to 19 percent in 1994 as the economy improved and the tax increases enacted in the Omnibus Budget Reconciliation Act of 1993 took effect.

Over the last 35 years, important shifts have occurred in the major sources of revenue--individual, social insurance, corporate, and excise taxes (see Figure 5-2). Individual income taxes--the largest component of total revenues--have risen and fallen as a share of GDP since 1960, but are currently near their average level of 8.4 percent. The individual income tax share of GDP exceeded 9 percent in 1969 and 1970, when Congress enacted an income tax surcharge, and again in the 1979-1982 period, when rapid inflation led to bracket creep that pushed up revenues. Individual income taxes peaked at 9.6 percent of GDP in 1981. Their share of GDP bottomed out at 8 percent in 1992, following the 1990-1991

Table 5-1.
CBO Baseline Projections for Revenues, by Source (By fiscal year)

Source	Actual 1994	1995	1996	1997	1998	1999	2000
			In Billions of Dollars				
Individual Income	543	594	628	656	693	731	772
Corporate Income	140	149	151	155	161	167	173
Social Insurance	461	494	517	539	565	590	618
Excise	55	56	56	57	58	59	59
Estate and Gift	15	16	17	18	19	19	20
Customs Duties	20	21	21	21	21	22	23
Miscellaneous	22	25	28	29	30	30	31
Total	1,257	1,355	1,418	1,475	1,546	1,618	1,697
On-budget	922	998	1,043	1,084	1,135	1,187	1,245
Off-budget[a]	335	357	375	392	411	431	452
			As a Percentage of GDP				
Individual Income	8.2	8.4	8.5	8.5	8.5	8.5	8.6
Corporate Income	2.1	2.1	2.1	2.0	2.0	2.0	1.9
Social Insurance	7.0	7.0	7.0	7.0	6.9	6.9	6.9
Excise	0.8	0.8	0.8	0.7	0.7	0.7	0.7
Estate and Gift	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Customs Duties	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Miscellaneous	0.3	0.4	0.4	0.4	0.4	0.4	0.3
Total	19.0	19.3	19.2	19.0	19.0	18.9	18.8
On-budget	13.9	14.2	14.2	14.0	13.9	13.9	13.8
Off-budget[a]	5.1	5.1	5.1	5.1	5.0	5.0	5.0

SOURCE: Congressional Budget Office.

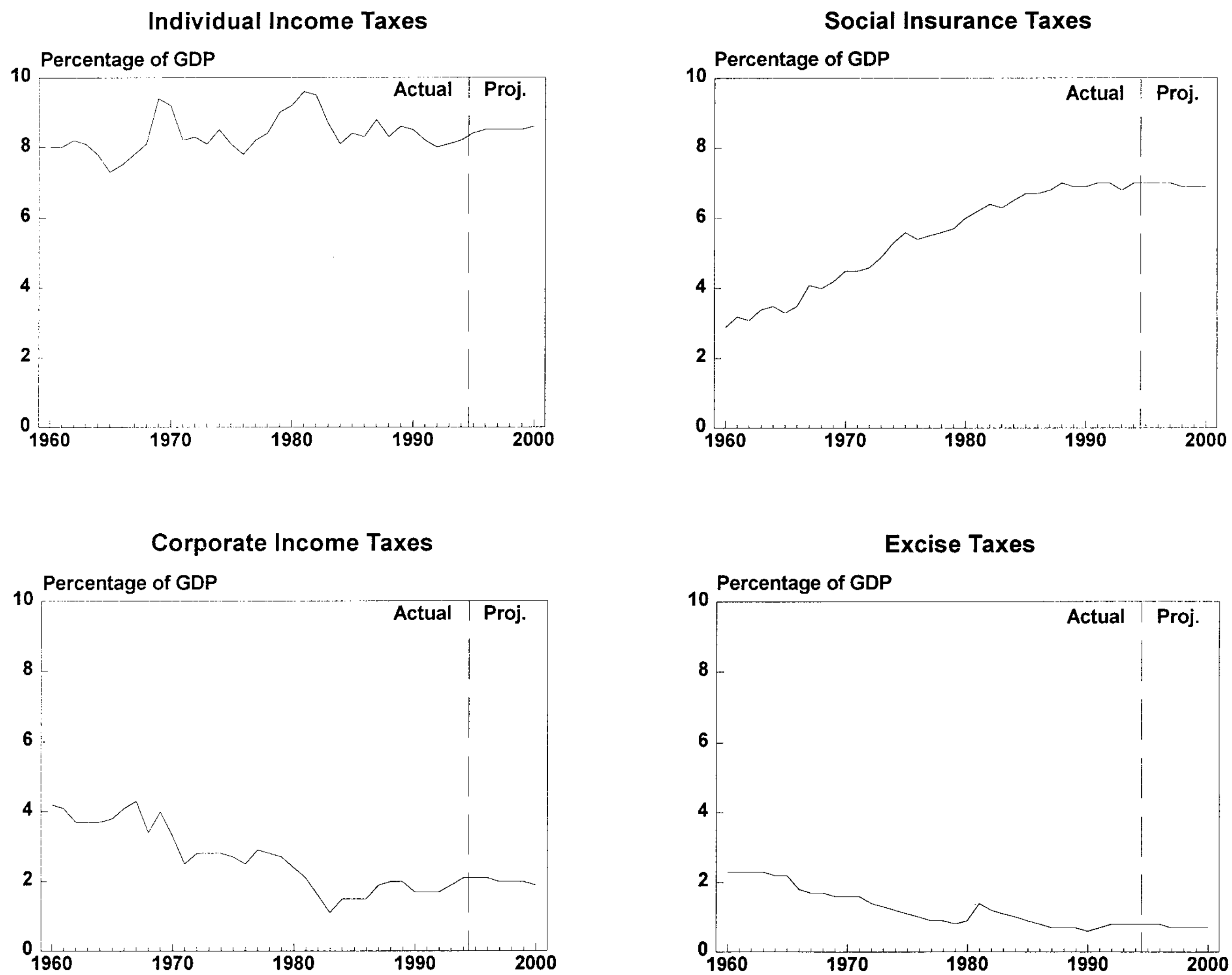
a. Social Security.

recession, the lowest level since 1976, after the 1974-1975 recession. Barring any new legislation affecting revenues, CBO expects that individual income tax revenues will claim about 8.5 percent of GDP for the remainder of the decade.

The share of GDP claimed by corporate income taxes fell between 1960 and the mid-1980s because of both a drop in corporate profits as a share of GDP and legislated reductions in tax liability. The share averaged just below 4 percent in the 1960s, just below 3 percent in the 1970s, and just below 2 percent in the 1980s. Corporate taxes as a share of GDP have grown slightly since the Congress raised corporate taxes in the Tax Reform Act of 1986. Hence, CBO expects that the revenue share of corporate taxes will average 2 percent of GDP from 1995 through 2000.

The share of GDP claimed by social insurance taxes (mostly Social Security) increased steadily between 1960 and the late 1980s as tax rates, coverage, and the share of wages subject to taxation all grew.

Figure 5-2.
Revenues by Source as a Share of GDP



SOURCE: Congressional Budget Office.

The share swelled from nearly 3 percent of GDP in 1960 to 7 percent by 1988, about where it is today. Revenues from social insurance taxes equaled about 30 percent of combined individual and corporate income tax revenues in the 1960s, 60 percent of combined income tax revenues in the 1980s, and about 70 percent today.

Excise taxes represent only a small share of federal revenues. They have claimed a decreasing share of GDP over time largely because most are levied on the quantity, not the value, of goods, and in general rates have not been raised enough to keep pace with inflation.

This chapter presents a broad range of options for increasing federal revenue. The options would raise revenue from all of the major revenue sources. But they differ in the way they would affect the allocation of economic resources among alternative uses and the distribution of tax burdens among taxpayers.

Some Members of Congress are interested in more dramatic changes in the way revenue is raised. Indeed, interest in structural changes in the tax system has persisted for a long time. As Henry Aaron, Harvey Galper, and Joseph Pechman wrote in 1988 in the introduction to *Uneasy Compromise: Problems of a Hybrid Income-Consumption Tax*:

> For decades U.S. tax experts have been debating whether the nation would be better served by an income tax or by a consumption tax. Both taxes would apply to total household resources and both taxes can be levied at graduated rates. The essential difference is that the consumption tax exempts saving, while the income tax does not.[1]

Some of the tax proposals that the Congress may consider this year would move the present income tax system closer to a consumption tax--for example, neutral cost recovery is proposed in the Contract with America supported by the Republican majority in the House of Representatives. Some proposals would go even further than neutral cost recovery. Many Members of Congress have expressed interest in a full or partial replacement of income taxes with a consumption tax, citing increased national saving and reduced complexity of the tax system as some of the potential advantages of such a switch. Whether such a major restructuring will eventually be put in place depends on how well an actual consumption tax system would produce those advantages while meeting other important criteria such as revenue capacity and equity among taxpayers.

Neither the individual income tax nor the corporate income tax in place today is a pure tax on income. Each tax combines elements of both income and consumption taxation. For example, saving through employment-related pensions, 401(k) plans, and, for some workers, individual retirement accounts is tax-exempt under the current income tax, just as it would be under a consumption tax. Although not fully tax-exempt as under a consumption tax, investment generally receives more favorable depreciation treatment under the present income tax than it would under a pure income tax. Both the individual and corporate income tax have features that are not compatible with either pure income or pure consumption taxation--features designed to further other policy goals. For example, the deduction of contributions to charity under the income tax encourages charitable activities, and the exemption of employment-related health insurance premiums helps to broaden health insurance coverage. Such features address widely accepted social objectives and might well also be included in a consumption tax enacted to replace the present income tax system.

In reviewing the options presented in this chapter, try to determine whether they are consistent with an income- or consumption-based tax system or both. A number of options would raise revenues by moving toward more comprehensive income taxation--for example, limiting tax preferences for retirement saving (REV-12 and REV-13), capital gains (REV-21 and REV-22), and life insurance and annuities (REV-16). Options consistent with a shift toward consumption-based taxes include introducing a value-added tax (REV-33) or a broad-based energy tax (REV-34). A third set of options would raise revenues by eliminating or curtailing preferences in the tax code--for example, taxing employment-related health and life insurance benefits (REV-10 and REV-11) or lim-

1. Henry Aaron, Harvey Galper, and Joseph Pechman, eds., *Uneasy Compromise: Problems of a Hybrid Income-Consumption Tax* (Washington, D.C.: Brookings Institution, 1988).

iting itemized deductions for home mortgage interest, state and local taxes, and charitable contributions (REV-04, REV-05, and REV-06). Those options would be consistent with a comprehensive tax on either income or consumption.

The options differ in their implications for the cost of administration by the Internal Revenue Service and the cost of compliance by taxpayers. Some would raise revenue from existing tax sources by increasing tax rates, broadening tax bases, or expanding tax coverage to include additional taxpayers. The government could put many of those options into place quickly and easily because the taxes are already in place. Other options would raise revenue from new tax sources such as a federal value-added tax or a broad-based energy tax. Those options could impose substantial additional compliance costs on taxpayers and administrative costs on the federal government because they would require additional methods for computing taxes and more Internal Revenue Service employees.

One revenue-raising option--to make all entitlement payments subject to the individual income tax--appears not in this chapter but in Chapter 4, which discusses entitlement payments and other mandatory spending. That option is part of the ENT-68 option, which would apply a means test to federal entitlement payments.

Although most of the spending options presented in this volume would take effect on October 1, 1995, all but one of the revenue options would take effect on January 1, 1996. The option for a value-added tax has a later effective date because implementing the tax would take more time. The revenue estimates for the options, most of which the Joint Committee on Taxation prepared, may differ from estimates for similar provisions in actual tax legislation because of differences in effective dates, transition rules, and technical details.

REV-01 RAISE MARGINAL TAX RATES FOR INDIVIDUALS AND CORPORATIONS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Individuals						
Raise Marginal Tax Rates to 16 Percent, 30 Percent, 33 Percent, 38 Percent, and 42 Percent, and Top AMT Rate to 30 Percent	24.5	42.1	44.0	46.2	48.3	205.1
Raise the Top Marginal Tax Rates to 38 Percent and 42 Percent	4.1	6.9	7.1	7.5	7.7	33.3
Corporations						
Raise the Top Marginal Tax Rate to 36 Percent	1.7	3.4	3.5	3.8	3.8	16.2
Raise the AMT Rate to 25 Percent	1.3	3.0	2.9	2.5	2.3	12.0

SOURCE: Joint Committee on Taxation.

NOTE: AMT = alternative minimum tax.

Rate increases have some administrative advantages over other types of tax increases because they require relatively minor changes to the current tax collection system. But rate increases have drawbacks as well. Higher tax rates can reduce incentives to work and save, and encourage taxpayers to shift income from taxable to nontaxable forms (such as substituting tax-exempt bonds for other investments or tax-free fringe benefits for cash compensation) and to increase spending on tax-deductible items such as home mortgage interest and charitable contributions. In those ways, they exacerbate economic inefficiencies.

Individuals. Under current law, five explicit marginal tax rates apply to taxable income: 15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent. (The marginal tax rate is the percentage of an extra dollar of income that a taxpayer must pay in taxes.) The maximum marginal tax rate on capital gains income is 28 percent. Some taxpayers face effective marginal rates higher than the top rate of 39.6 percent because of provisions that phase out their itemized deductions and personal exemptions. For 1995, the levels of taxable income at which the marginal rates apply are shown in Table 5-2.

Increasing all marginal tax rates on ordinary income to 16 percent, 30 percent, 33 percent, 38 percent, and 42 percent (approximately a 7 percent increase) would raise about $205 billion in 1996 through 2000. This option would also increase the top marginal tax rate under the alternative minimum tax (AMT) to 30 percent in order to keep the rate aligned with the regular tax rates and avoid a major

shift of payments between the AMT and regular tax. The AMT is now imposed on individuals at rates of 26 percent and 28 percent on a broader base. Individuals pay the larger of the AMT or the regular tax. Under this option, families with tax credits would face a somewhat larger percentage increase in their tax liabilities than other taxpayers, and families whose earned income tax credit gives them a tax refund might have to pay tax. (This option and the next one assume that the maximum rate on capital gains would remain at 28 percent.)

Another option is to increase only the top two marginal tax rates. Increasing the current 36 percent rate to 38 percent and the 39.6 percent rate to 42 percent would raise revenues by about $33 billion in 1996 through 2000. For 1996, this option would increase taxes for married couples with taxable income of more than $147,950 and single filers with taxable income of more than $121,550. The change would affect just over 1 percent of tax filers.

The estimates assume that taxpayers will change their behavior in a variety of ways if marginal tax rates are raised, chiefly by shifting income from taxable to nontaxable or tax-deferred forms. The estimates do not assume any change in total hours worked. Increasing all marginal tax rates may have little effect on hours worked because of offsetting incentives. Since higher tax rates reduce the returns from working (each hour of work produces less take-home pay), workers may be unwilling to work the same number of hours as before. But since higher tax rates also reduce after-tax income, taxpayers may wish to work more in order to maintain the same level of disposable income.

Table 5-2.
Individual Income Tax Brackets, 1995 (In dollars)

Taxable Income for Single Filers	Marginal Tax Rate (Percent)	Taxable Income for Married Couples
0 to 23,349	15.0	0 to 38,999
23,350 to 56,549	28.0	39,000 to 94,249
56,550 to 117,949	31.0	94,250 to 143,599
117,950 to 256,499	36.0	143,600 to 256,499
256,500 and Over	39.6	256,500 and Over

SOURCE: Internal Revenue Service.

NOTE: Separate schedules apply for taxpayers who are heads of households or who are married and file separate returns.

Increasing only the top two marginal tax rates might have a greater effect on hours of work. Taxpayers with taxable income just above the level at which the new rates would apply would see little reduction in their after-tax income, but they would experience a decrease in the return from working additional hours. As a result, they would most likely cut back on hours of work, which would reduce some of the revenue pickup from the increase in rates.

Corporations. The tax rate for corporations is 15 percent on taxable income up to $50,000, 25 percent on income from $50,000 to $75,000, 34 percent on income from $75,000 to $10 million, and 35 percent on income above $10 million. The tax benefit from the 15 percent, 25 percent, and 34 percent rates is recaptured for corporations with income above certain amounts by an additional 5 percent tax that is levied on taxable income between $100,000 and $335,000 and a 3 percent additional tax on income between $15 million and $18.3 million (see REV-03).

Corporations also face the alternative minimum tax, which limits their use of tax preferences. When computing taxable income for the alternative minimum tax, taxpayers may not make certain adjustments that are otherwise allowed in computing regular taxable income. Those adjustments are of two types: deferral preferences, such as accelerated depreciation, excess intangible drilling costs, and profit or loss from long-term contracts; and exclusion preferences, such as some tax-exempt interest and percentage depletion. As with individuals, corporations must pay the larger of the regular tax or the AMT and can use one year's AMT as a credit against regular tax liability in future years. (Individuals can only use as credits the portion of the AMT that arises from deferral preferences.) Thus, a portion of the revenue gain from a higher AMT rate would result from a shift of some future tax liabilities to earlier years.

Increasing the top marginal rate for corporations to 36 percent would raise about $16.2 billion in 1996 through 2000. Out of approximately 1 million corporations that have positive corporate tax liabilities each year, fewer than 3,000 pay income taxes at the top rate and would be affected by this option. Nonetheless, those firms earn approximately 80 percent of all corporate taxable income. The change would not, however, affect corporations that always pay the AMT. Moreover, those corporations paying the regular tax, but with unused credits, could offset some of the tax increase.

Boosting the corporate AMT rate to 25 percent would raise about $3 billion in 1997 but decreasing amounts thereafter because the revenue raised represents a shift of future liabilities to earlier years, as described earlier. Proponents of the corporate AMT argue that it improves the perceived fairness of the tax system because it largely ensures that corporations reporting profits to shareholders pay the corporate tax. Critics maintain, however, that the corporate AMT places a greater tax burden on rapidly growing and heavily leveraged corporations and provides corporations with an incentive to engage in tax-motivated transactions. For example, a firm that expects to pay the AMT may be able to reduce its tax by leasing its equipment rather than owning the equipment and using the accelerated depreciation tax preference.

Relationship Between Top Rates Affects Business Form. Changes in the difference between the top corporate and individual tax rates affect the form of organization a business chooses. Owners of corporate businesses pay both the corporate and individual income tax on their business income, whereas owners of noncorporate businesses pay tax only at the individual level. At present, the top individual tax rate is above the corporate tax rate, making it relatively more advantageous for businesses that retain their earnings to choose the corporate form. Subsequent changes in that relationship would alter the incentives that businesses face when they choose their organizational form.

REV-02 AMEND OR REPEAL THE INDEXING OF INCOME TAX SCHEDULES

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Suspend Indexing for 1996 (Except for the earned income tax credit)	5.7	10.3	11.9	12.5	12.9	53.3
Repeal Indexing (Except for the earned income tax credit)	5.7	16.3	29.2	43.4	58.8	153.4

SOURCE: Joint Committee on Taxation.

To offset the effects of inflation, current law each year indexes the standard deduction, the personal exemption, the minimum and maximum dollar amounts for each tax rate bracket, the thresholds for the phaseout of personal exemptions, the limit on itemized deductions, and the earned income tax credit (EITC). A repeal of indexing (except for the EITC), beginning in 1996, would raise revenues by about $153 billion from 1996 through 2000, if the annual rate of inflation averages 3.3 percent over the period, as the Congressional Budget Office projects. Revenues from the repeal would grow rapidly as the effect of repeal cumulated over time. Although suspending indexing only for 1996 would raise the same amount of revenues in the first year, it would raise much less in later years--about $53 billion over the five-year period.

An alternative to suspending or repealing indexing is to index by something less than the full annual increase in the consumer price index (CPI) that applies under current law. If the CPI tends to overstate the increase in the cost of living, as some evidence suggests, then indexing by less than the full CPI increase would be appropriate. Indexing by 0.5 percentage points less than the estimated increase in the CPI would raise revenues and reduce EITC outlays by about $11 billion per year by 2000 and by increasing amounts in subsequent years.

Repealing or suspending indexing would not burden all taxpayers equally. Among families with the same income, the tax increase would be smaller for taxpayers who itemize than for those who use the standard deduction, and for families without children than for families with children (and more personal exemptions). As long as the EITC continued to be indexed, low-income families would have a smaller percentage drop in after-tax income than other families because they have little or no taxable income. The percentage drop in after-tax income would also be small for families with the highest incomes because they receive no benefit from the personal exemption, and most of them do not take the standard deduction. A general rate increase would allocate additional taxes more equally among families with the same income than repealing or suspending indexing (see REV-01).

Another reason for retaining indexing is that it allows the Congress to decide explicitly on tax increases. Without indexing, inflation would cause the average income tax rate to increase without any legislative action.

REV-03 TAX ALL CORPORATE INCOME AT A 35 PERCENT RATE

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	1.6	3.5	3.5	3.5	3.6	15.7

SOURCE: Joint Committee on Taxation.

Under current law, corporations pay a 35 percent statutory tax rate on their taxable income in excess of $10 million. Income below that amount is subject to tax at reduced rates of 15 percent, 25 percent, and 34 percent. Eliminating the reduced corporate rates and taxing all corporate income at the single 35 percent rate would raise an estimated $15.7 billion from 1996 through 2000.

Firms with taxable income below $75,000 have tax rates of 15 percent or 25 percent. Firms with taxable income between $75,000 and $10 million have a tax rate of 34 percent, and those with income above $10 million have a 35 percent rate. Compared with a single 35 percent statutory rate, corporations with taxable income between $10 million and $15 million pay $100,000 less in taxes--the maximum benefit from the lower rates.

The tax benefit from the reduced rates is phased out for corporations with income above certain amounts by an additional 5 percent tax that is levied on corporate taxable income between $100,000 and $335,000 and a 3 percent additional tax on income between $15 million and $18.3 million. As a result, corporations with income of more than $18.3 million pay an average rate of 35 percent and receive no benefit from the reduced rates.

The Congress enacted the reduced rates to provide tax relief to small and moderate-sized businesses. Of the approximately 1 million corporations that have positive corporate tax liabilities each year, all but about the most profitable 3,000 qualify for reduced rates, although the lower-rate corporations earn only about 20 percent of total corporate profits. That provision not only provides a competitive advantage to some small and moderate-sized businesses, but other taxpayers benefit as well. For example, high-income individuals benefit because the provision allows them to shelter income as retained earnings in a small corporation. The tax law does not allow owners of personal service corporations, such as physicians, attorneys, and consultants, to incorporate themselves in order to gain the tax benefit. Other high-income individuals still use those opportunities for tax shelters, however. The Omnibus Budget Reconciliation Act of 1993 increased the incentive to use those shelters by raising the top statutory income tax rate for individuals to nearly 40 percent, while raising the top statutory rate for corporations to 35 percent. Additional unintended recipients of the tax benefit are large businesses with low profits. Furthermore, some of those large corporations may be able to control the timing of certain income and expenses in order to generate low taxable income--and the tax benefit--in certain years.

The reduced corporate rates do lessen the "double taxation" of corporate income. Owners of corporate businesses pay corporate tax on all of the earnings of the business and also pay individual tax on the part of their earnings that they receive as dividends. Owners of noncorporate businesses, however, pay tax at only the individual level on all earnings.

Lower corporate rates are not the only means, however, of reducing the double tax on the income of those businesses. As an alternative to incorporation, many businesses--especially small ones--could operate as sole proprietorships or partnerships and pay tax only under the individual income tax. In addition,

many small businesses could continue to enjoy the advantages of incorporation by operating as S corporations, which must have 35 or fewer owners and satisfy other requirements. Shareholders in S corporations also pay only under the individual income tax.

REV-04 ELIMINATE OR LIMIT DEDUCTIONS FOR MORTGAGE INTEREST

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Eliminate Mortgage Interest Deductions	41.1	62.2	66.0	69.9	74.1	313.3
Reduce Maximum Mortgage Principal Eligible for Interest Deductions to $300,000	3.8	6.5	7.2	8.1	9.2	34.8
Limit Deductions to $12,000 per Return (Single) or $20,000 (Joint)	6.1	9.9	10.7	12.1	13.6	52.4
Limit Deductions for Second Homes	0.4	0.7	0.7	0.7	0.7	3.2

SOURCE: Joint Committee on Taxation.

A home is both the largest consumer purchase and the main investment for most Americans. The tax code has historically treated homes more favorably than other investments. Current law allows homeowners to deduct mortgage interest expenses, even though homes do not produce taxable income, and exempts most capital gains from home sales (see REV-21). Such preferential treatment may benefit neighborhoods because it encourages home ownership and home improvement. The amount of preference, however, is probably larger than needed to maintain a high rate of home ownership. For example, Canada, which grants preferential tax treatment to capital gains from home sales but does not allow deductions for mortgage interest, has achieved about the same rate of home ownership as the United States.

The tax advantages for owner-occupied housing encourage people to invest in homes instead of taxable business investments. That shift may contribute to a relatively low rate of investment in business assets in the United States compared with other developed countries that do not allow such large mortgage interest deductions. Currently, about one-third of net private investment goes into owner-occupied housing. Consequently, even a modest reduction in housing investment could raise investment significantly in other sectors.

Limiting mortgage interest deductions would substantially reduce the preferential treatment of owner-occupied homes, particularly for those homeowners who must borrow to purchase their homes. Under current law, taxpayers may deduct interest on up to $1 million of debt they have used to acquire and improve first and second homes and interest on up to $100,000 of other loans they have secured with a home, regardless of purpose (home-equity loans). No other type of consumer interest is deductible. Current law also limits the extent to which interest deductions for carrying assets other than first and second homes can exceed income from such assets.

The limits under current law on mortgage interest deductions result in a generous subsidy even for relatively expensive homes. Moreover, taxpayers with substantial home equity can circumvent the limits on

consumer and investment interest deductions by using, for example, home-equity loans with deductible interest to finance automobiles and other consumer purchases or investment in assets other than homes. In contrast, renters and those with small amounts of home equity cannot use that method to deduct interest on the loans they use to finance auto and other purchases.

Eliminate Interest Deductions. Eliminating the deductibility of mortgage interest would raise the taxes of about 28 million homeowners by an average of about $2,100 in 1996 and increase tax revenues by about $313 billion over the 1996-2000 period. Housing as an investment would be made more nearly equal with other investment opportunities, thus reducing the incentive to overinvest in housing. Furthermore, eliminating the deduction would remove the opportunity for homeowners to circumvent provisions in the tax law that deny the deductibility of interest on other types of consumer expenditures. But eliminating the mortgage interest deduction would increase net mortgage payments sharply for current homeowners, potentially making it impossible for some to afford their homes. Eliminating the mortgage interest deduction would also cause the value of higher-priced homes to fall and would hurt homebuilders. Finally, the higher tax burden would fall most heavily on people who do not have sufficient wealth to purchase homes without mortgages but still itemize their deductions.

Reduce the Principal Eligible for Deduction. Lowering the limit on the amount of principal eligible for the mortgage interest deduction from $1 million to $300,000 would reduce deductions for about 1.2 million taxpayers with large mortgages and increase revenues by about $35 billion over the 1996-2000 period. That change would reduce the deduction only for owners of relatively expensive homes. It would not affect the vast majority of homeowners. The fraction affected would be greater in high-cost areas such as Honolulu and San Francisco. Because the proposal would not index the limits for inflation, the real value would gradually decline. Phasing down the limit gradually would cushion the effects on most current homeowners and the homebuilding industry.

Cap Interest Deductions. Capping the mortgage interest deduction would have effects similar to limiting the principal eligible for deduction. One difference is that fluctuating interest rates would affect deductions subject to the interest cap but would not affect deductions subject to the limit on mortgage principal. Capping the mortgage interest deduction at $12,000 per single return, $20,000 per joint return, and $10,000 per return for married couples who file separately would raise about $52 billion in revenues in 1996 through 2000. Those limits are much higher than the deductions most taxpayers claim. Of the 27 million taxpayers who claimed the mortgage interest deduction in 1992, about 1.5 million (5 percent) had deductions that exceeded those limits; the average deduction for home mortgage interest was about $7,300. At current mortgage interest rates, the proposed $20,000 cap would allow full interest deductions on new fixed-rate mortgages as large as about $225,000. Only 6 percent of new mortgages originated in 1994 exceeded that amount.

Like the other limits on interest deductions, the cap would be more restrictive in areas with higher housing costs. Further, in periods of high interest rates, the limits would affect recent homebuyers and those with adjustable-rate mortgages more than longer-term owners with fixed-rate mortgages.

Limit Interest Deductions for Second Homes. A final option is to limit deductibility only to interest on debt that taxpayers incur to acquire and improve a primary residence, plus $100,000 of other debt secured by that home. That approach would require interest deductions for second homes to qualify under the $100,000 limit on home-equity loans. The proposal would increase revenue by $3.2 billion in 1996 through 2000.

The deduction under current law provides special treatment for taxpayers who borrow to own second homes, relative to taxpayers who cannot deduct interest from consumer loans used to finance education, medical expenses, and other consumer purchases. Many second homes are vacation homes. Yet limiting the deduction of mortgage interest to a single home would retain the present preference for taxpayers with high mortgage interest on a costly primary home while denying it to other taxpayers with lower combined mortgage interest on two less costly homes.

REV-05 ELIMINATE OR LIMIT DEDUCTIONS OF STATE AND LOCAL TAXES

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Eliminate Deduction of State and Local Taxes	18.5	46.5	49.3	52.3	55.5	222.1
Limit Deductions to the Excess over 1 Percent of Adjusted Gross Income	2.1	7.0	7.4	7.8	8.2	32.5
Prohibit Deductibility of Taxes Above Ceiling of 8 Percent of Adjusted Gross Income	2.2	7.3	7.9	8.5	9.1	35.0

SOURCE: Joint Committee on Taxation.

Under current law, taxpayers may deduct state and local income, real estate, and personal property taxes from their adjusted gross income (AGI). For taxpayers who itemize, the deductions provide a federal subsidy of state and local tax payments. That subsidy may cause itemizers to support higher levels of state and local services than they would otherwise; consequently, the deductions indirectly finance increased state and local government spending at the expense of other uses of federal revenues.

The Tax Reform Act of 1986 reduced the subsidy to state and local governments directly by repealing the deduction for state and local sales taxes, and indirectly by increasing the standard deduction and lowering marginal rates. The latter changes reduced both the number of itemizers and the value of the deductions. The Omnibus Budget Reconciliation Act of 1993 raised marginal tax rates for higher-income households and thus indirectly increased the value of the deductions.

As a way to assist state and local governments, deductibility of state and local taxes has several disadvantages. First, the deductions reduce federal tax liability only for itemizers. Second, because the value of an additional dollar of deductions increases with the marginal tax rate, the deductions are worth more to higher-bracket taxpayers. Third, deductibility favors wealthier communities. Communities with higher average income levels have more residents who itemize and are therefore more likely to spend more because of deductibility than lower-income communities. Fourth, deductibility may discourage states and localities from financing services with nondeductible user fees, thereby discouraging efficient pricing of some services.

An argument against restricting deductibility is that a taxpayer with a large state and local tax liability has less ability to pay federal taxes than one with equal total income and a smaller state and local tax bill. In some areas, a taxpayer who pays higher state and local taxes may receive more benefits from publicly provided services, such as recreational facilities. In that case, the taxes are more like other payments for goods and services (for example, private recreation) and should not be deductible. Alternatively, higher public expenditures resulting from deductibility benefit all members of a community, including lower-income nonitemizers who do not receive a direct tax saving.

Eliminating or limiting the value of the state and local deduction could raise significant revenues. Eliminating deductibility would raise more than $220

billion in 1996 through 2000. An alternative option would allow deductions only for state and local tax payments above a fixed percentage of AGI. A 1 percent floor on deductions would increase revenues in 1996 through 2000 by $32.5 billion. Another alternative would be to prohibit deductions above a fixed ceiling, which also might be a percentage of AGI. A ceiling set at 8 percent of AGI would increase revenues by a roughly similar amount--$35 billion in 1996 through 2000. A floor and a ceiling, however, would have very different effects on incentives for state and local spending. A floor would retain the incentive for increased spending, but a ceiling would reduce it.

REV-06 ELIMINATE OR LIMIT DEDUCTIONS FOR CHARITABLE GIVING

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Eliminate Deductions for Charitable Giving	1.8	17.7	18.6	19.3	20.2	77.6
Limit Deductions for Appreciated Property to Its Tax Basis	0.1	1.4	1.4	1.5	1.5	5.9
Limit Deductions to the Excess over 2 Percent of Adjusted Gross Income	0.9	8.6	9.1	9.5	10.0	38.1

SOURCE: Joint Committee on Taxation.

Under current law, taxpayers who itemize deductions can deduct the value of contributions they make to qualifying charitable organizations. The amount of deductions cannot exceed 50 percent of adjusted gross income in any year. In 1993, 30 million taxpayers claimed $67 billion of deductions for charitable contributions, reducing federal revenues by about $17 billion.

In addition to cash donations, taxpayers can deduct the fair market value of a contribution of appreciated property that they have held for more than 12 months, regardless of how much they paid for the property.

Eliminating the deductibility of charitable contributions would increase tax revenues by $1.8 billion in 1996 and by about $78 billion over the 1996-2000 period. In 1997, it would increase tax payments of about 30 million taxpayers by an average of nearly $600 per return.

The deduction provides significant government support for charitable activities. But one criticism of the deduction is that the electorate as a whole, and not individual donors, should make decisions about which activities deserve taxpayer support. Another criticism is that the deduction provides unequal federal matching rates for contributions by different taxpayers. The government subsidy rates can exceed 40 percent of contributions for the highest-income taxpayers, but are only 15 percent for taxpayers in the lowest tax bracket and zero for people who do not itemize deductions.

Nonetheless, the decisions of individuals about donations may be the best measure of which activities should receive government support and yield substantial contributions. Without deductibility, contributions might drop precipitously.

Limiting the deduction of appreciated property to a taxpayer's cost of an asset under the regular income tax would increase revenues by about $0.1 billion in 1996 and by nearly $6 billion over five years. The existing provision allows taxpayers to deduct the entire value of assets they contributed even though they paid no tax on the gain from appreciation. That outcome provides preferential treatment to one kind of donation relative to other kinds and expands the preferential treatment of capital gains (see REV-22). However, the provision encourages people to donate appreciated assets to eligible activities rather than passing them on to their heirs at death, when any gains also escape income tax.

Another way to limit the charitable deduction, while retaining an incentive for giving, is to allow

taxpayers to deduct only those contributions in excess of 2 percent of adjusted gross income. That alternative would retain an incentive for increased giving by people who give a large share of their income but would remove the incentive for smaller contributors. It would completely disqualify the charitable deductions of about 17 million taxpayers in 1996 and reduce allowed deductions for an additional 13 million, increasing revenues by about $0.9 billion in 1996 and by $38 billion over the 1996-2000 period. Such a change would eliminate the tax incentive for about 60 percent of the taxpayers who currently make and deduct charitable contributions. In addition, it would encourage taxpayers who planned to make contributions over several years to lump them together in one tax year to qualify for a deduction with the 2 percent floor.

REV-07 LIMIT THE TAX BENEFIT OF ITEMIZED DEDUCTIONS TO 15 PERCENT

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	27.2	60.8	64.4	68.2	72.1	292.7

SOURCE: Joint Committee on Taxation.

Current law allows taxpayers to reduce taxable income by the amount of itemized deductions in excess of the standard deduction. Taxpayers who itemize may deduct state and local income and property taxes, home mortgage interest payments, contributions to charity, employee business expenses, moving expenses, casualty and theft losses, and medical and dental expenses. Current law limits some itemized deductions to the amount in excess of a percentage of adjusted gross income and reduces all itemized deductions for high-income taxpayers.

The tax benefit of itemized deductions increases with a taxpayer's marginal tax bracket. For example, $10,000 in itemized deductions would reduce taxes by $1,500 for a taxpayer in the 15 percent tax bracket, $2,800 for a taxpayer in the 28 percent bracket, and $3,960 for a taxpayer in the 39.6 percent bracket. Most taxpayers do not itemize deductions. Among the one in four taxpayers who do itemize, however, about half are in tax brackets above 15 percent. This option would limit the tax benefit of itemized deductions to 15 percent for those higher-bracket taxpayers. The limit would increase revenues by almost $300 billion over five years.

Limiting the tax benefit of itemized deductions would make the income tax more progressive by raising average tax rates for most middle- and upper-income taxpayers. The limit might also improve economic efficiency because it would reduce tax subsidies that distort the after-tax prices of goods, such as owner-occupied housing.

The itemized deductions for health expenses, casualty losses, and employee business expenses, however, are not subsidies of voluntary activities, but are instead allowances for costs that reduce the ability to pay income tax. Under this option, some taxpayers would pay tax on receipts they use to defray such costs because they would pay tax on their gross income at rates above 15 percent, but could deduct only 15 percent of the cost of earning income. Thus, an individual with unusually high medical bills, for example, would pay more tax than another individual with the same ability to pay but who had low medical bills.

Like other limits on itemized deductions, this option would create incentives for taxpayers to avoid the limit by converting itemized deductions into reductions in income. For example, taxpayers might draw down assets to repay mortgages, reducing both income and mortgage payments, or donate time or services rather than cash to charities. The option would also make calculating taxes more complex for itemizers.

REV-08 PHASE OUT THE DEPENDENT-CARE CREDIT

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Set the Phaseout Starting at:						
$30,000	0.9	1.5	1.5	1.6	1.7	7.2
$50,000	0.5	0.9	0.9	1.0	1.1	4.4
$65,000	0.3	0.5	0.6	0.6	0.7	2.7

SOURCE: Joint Committee on Taxation.

Taxpayers who incur employment-related expenses for the care of children and certain other dependents may claim an income tax credit. The credit per dollar of qualifying expenses declines from 30 percent for taxpayers whose adjusted gross income (AGI) is $10,000 or less to 20 percent for taxpayers whose AGI is above $28,000. The tax law limits creditable expenses to $2,400 for one child and $4,800 for two or more. Creditable expenses cannot exceed the earnings of the taxpayer or, in the case of a couple, the earnings of the spouse with lower earnings. In 1992, taxpayers claimed about $2.5 billion in credits on 6 million tax returns.

About 40 percent of the credit benefits families with incomes of $50,000 or more. Retaining the credit only for lower-income families would reduce its revenue cost. One way to do that would be to reduce the percentage of credit as income rises. For example, reducing the credit percentage by 1 percentage point for each $1,500 of AGI more than $30,000 would raise about $7.2 billion from 1996 through 2000. This option would reduce the credit for about 38 percent of currently eligible families and eliminate it for another 30 percent of those families (ones with AGI over $58,500). Alternatively, phasing out the credit between $50,000 and $78,500 would raise about $4.4 billion in the same period. This option would reduce the credit for about 25 percent of eligible families and eliminate it for another 14 percent. Finally, phasing out the credit between $65,000 and $93,500 would raise $2.7 billion in the same period, reducing the credit for about 17 percent of eligible families and eliminating it for another 8 percent.

The credit provides a work subsidy for families with children. Phasing out the credit for higher-income families targets that subsidy toward families with greater economic need, but may discourage parents in families with a reduced credit from working outside the home.

If the credit was phased out, higher-income employees could seek other tax benefits for dependent care by asking their employers to provide subsidized day care. Current law allows workers to exclude from taxable income up to $5,000 of annual earnings used to pay for dependent care through employer-based programs. To preclude taxpayers from using this alternative, the Congress could limit the use of the fringe benefit.

REV-09 IMPOSE AN EXCISE TAX ON NONRETIREMENT FRINGE BENEFITS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	4.3	6.5	7.0	7.5	8.0	33.3

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues.

Unlike employee compensation paid in cash, many fringe benefits are exempt from income and payroll taxes. The exemption of employer-paid health and life insurance premiums from tax will cost about $57 billion in income taxes and $38 billion in payroll taxes in 1996. In addition, the law explicitly excludes from gross income employer-paid dependent care and miscellaneous benefits such as employee discounts, parking valued below a specified limit, and athletic facilities.

Those exclusions effectively subsidize the price of the fringe benefits, causing people to consume more of such benefits than they would if they had to pay the full price. As a result, resources may be allocated inefficiently. For example, excluding employer-provided parking facilities from taxation has encouraged people to drive to work rather than commuting by other means and encouraged employers to build parking facilities on land that might have more productive uses. (The parking subsidy has been partly offset in recent years by another fringe benefit: the exclusion for car pool subsidies and transit passes.) Excluding employer-provided health insurance has contributed to the large and growing demand for health care services. (See REV-10.)

Such exclusions are inequitable because an individual who earns compensation in cash pays more tax than one with the same total income, part of which is paid in the form of fringe benefits. That inequity is exacerbated to the extent that the higher demand for the fringe benefit by employees drives up the price for people who have to purchase it with after-tax dollars. Moreover, because the income tax is progressive (higher-income people pay higher tax rates), the tax exclusion is worth more to people with higher income. Higher-income people also receive more fringe benefits than lower-income people. As a result, the tax savings from the exclusion are very unevenly distributed among income groups.

Making all fringe benefits taxable, however, would present problems in valuing benefits and in assigning their value to individual employees. Appraisal is simple when the employer purchases goods or services and provides them to employees, but it is more difficult to determine the value of a facility, such as a gym, that employers provide. Further difficulties arise if the employer must allocate to individual employees the total value of the fringe benefits they provide. For example, in cases in which the employer provides a service, such as employee discounts, it might be unfair to assign the same taxable value to all employees regardless of their level of use. Conversely, it would be administratively complex to assign values that depended on each worker's use. Further, the costs of collecting taxes on small fringe benefits (such as employee discounts) might exceed the revenue collected.

An alternative to including employer-provided benefits as income to recipients would be to impose on employers an excise tax on the value of the benefits that they provide. Those benefits would include the employer's share of health insurance (see REV-10); premiums to fund the first $50,000 of life insurance, the part that is excluded from income (see REV-11); dependent care; athletic facilities; employee discounts; and parking with a value up to the

amount above which it is currently taxed. (Under current law, employees must include in taxable income in 1995 the market value in excess of $160 per month, indexed for inflation beyond 1995, of any parking provided free of charge by an employer.) A 3 percent tax, for example, would raise about $33 billion from 1996 through 2000. The bulk of those revenues would come from taxing employer-paid health insurance.

Under this option, employers would need to know only their total fringe benefit costs; they would not have to place a value on the benefits paid to each employee. Because the 3 percent excise tax rate would be much lower than the tax rate on wages, this option would maintain most of the incentive for employers to provide fringe benefits instead of taxable wages.

A flat-rate excise tax on employers would be relatively more favorable to higher-income employees than including fringe benefits in employees' taxable income. Under an excise tax, the rate would not rise with the income of employees, as it would if the benefits were subject to the income tax.

REV-10 TAX EMPLOYER-PAID HEALTH INSURANCE

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Tax Some Employer-Paid Health Insurance						
Income Tax	7.0	10.3	11.8	13.5	15.4	58.0
Payroll Tax	4.9	7.1	8.1	9.3	10.6	40.0
Total	11.9	17.4	19.9	22.8	26.0	98.0
Tax All Employer-Paid Health Insurance, but Allow Individuals a Credit for Premiums They or Their Employers Pay up to a Limit						
Income Tax	24.9	-0.4	-0.2	0.1	0.6	25.0
Payroll Tax	26.1	36.7	39.4	42.1	45.1	189.4
Total	51.0	36.3	39.2	42.2	45.7	214.4

SOURCE: Joint Committee on Taxation.

Employees do not pay taxes on income they receive in the form of employer-paid health insurance. In addition, health insurance premiums and health care costs paid through a cafeteria plan are generally excludable from income and payroll taxes. Those exclusions will reduce income tax revenues and payroll tax revenues by a total of about $92 billion in 1996. Limiting or modifying the tax exclusion represents an incremental approach toward some of the objectives for health policy stated by the Administration and Congressional reformers that could also reduce the deficit. Some comprehensive health policy proposals introduced in the previous Congress included limits on the tax exclusion.

Tax Some Employer-Paid Health Insurance. One way to limit the exclusion would be to treat as taxable income for employees any employer contributions for health insurance plus health care costs paid through cafeteria plans that exceed $360 a month for family coverage and $170 a month for individual coverage. Those amounts are estimated averages for 1996, which would be indexed to reflect future increases in the general level of prices. The option would raise income tax revenues by $58 billion and payroll tax revenues by $40 billion over the 1996-2000 period. Including employer-paid health care coverage in the Social Security wage base, however, would lead to increased outlays on Social Security benefits that could offset most of the added payroll tax revenues from this option over the long run.

An advantage of this approach is that it would eliminate the tax incentive to purchase additional coverage beyond the ceiling. Without such coverage, there would be stronger incentives to economize in the medical marketplace, thereby reducing upward pressure on medical care prices and the provision of unnecessary or marginal services. Because the option indexes the ceiling amounts to the overall inflation rate, while health care costs have been rising faster than inflation, it could constrain health care costs even more over time. The Congress has already limited the exclusion for employer-paid group term life insurance in a similar way.

One disadvantage of limiting the tax exemption of employer-paid medical insurance premiums is the difficulty of determining when extensive coverage becomes excessive. Also, a given premium pur-

chases different levels of coverage depending on such factors as geographic location and the characteristics of the firm's workforce. As a result, a uniform ceiling would have uneven effects. Finally, if health insurance costs continued to rise faster than the general level of prices, indexing to reflect the general level of prices would gradually reduce subsidies for employer-paid health insurance. The result of all of those factors could be to increase the number of workers without health insurance.

Tax All Employer-Paid Health Insurance, but Allow Individuals a Credit for Premiums They or Their Employers Pay up to a Limit. Another option would treat all employer-paid health insurance premiums as taxable income and disallow payments for health care costs through cafeteria plans, but offer a refundable individual income tax credit of 20 percent for health insurance premiums up to the amounts described above for family and individual coverage. The credits would be available to taxpayers whether or not their employers paid for or sponsored the coverage. The option would increase income tax revenues by $25 billion over the 1996-2000 period. That amount would be the net result of about $250 billion in revenues if there was no credit, less about $225 billion in new income tax credits. The net income tax gain occurs largely in the first year because many taxpayers would not adjust their withholding to take account of the credit. Payroll tax revenues would rise substantially, however--by about $190 billion over the same period. But as under the first option, increases in Social Security outlays could offset most of the added payroll tax revenues in the long run.

In addition to eliminating the tax incentive for excessive health insurance, as under the first alternative, an added advantage of this option is that the subsidy would be available to all taxpayers who purchased health insurance, without regard to their employment status. Moreover, the subsidy per dollar of eligible health insurance premiums would no longer be relatively higher for taxpayers with higher marginal tax rates (and higher incomes). Limiting the amount of insurance eligible for credits to a fixed level, however, creates all of the same problems as in the first option. Moreover, by extending the subsidy to individual purchases of insurance, the option might induce relatively healthy employees to buy insurance outside the work place. Consequently, insurance would become more expensive for the remaining employees, especially at small firms, and that rise in cost could cause more firms to terminate coverage.

REV-11 TAX EMPLOYER-PAID LIFE INSURANCE

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Income Tax	1.4	2.0	2.1	2.1	2.2	9.8
Payroll Tax[a]	0.8	1.2	1.2	1.2	1.3	5.7
Total	2.2	3.2	3.3	3.3	3.5	15.5

SOURCE: Joint Committee on Taxation.

a. Estimates are net of reduced income tax revenues.

The tax law excludes from taxable income the premiums that employers pay for group term life insurance, but limits the exclusion to the cost of the first $50,000 of insurance. The exclusion is not available to the self-employed. Employer-paid life insurance is the third most expensive tax-free fringe benefit (after health insurance, discussed in REV-10, and pensions, discussed in REV-12 and REV-13). Including employer-paid premiums in taxable income would add about $10 billion to income tax revenues and almost $6 billion to payroll tax revenues from 1996 through 2000.

Like the tax exclusion for other employment-based fringe benefits, the tax exclusion for life insurance creates a subsidy for the fringe benefit, which causes people to purchase more life insurance than they would if they had to pay the full cost for insurance. Furthermore, the tax exclusion allows workers who receive life insurance benefits to pay less tax than workers with the same total compensation but who must purchase insurance on their own (see REV-09). Unlike most other fringe benefits, however, the value of employer-paid life insurance would be easy to measure and allocate to employees. Employers could report the premiums they pay for each employee on the employee's W-2 form and compute withholding in the same way as for wages. Employers already withhold taxes on life insurance premiums that fund death benefits above the $50,000 limit.

Taxing employer-paid life insurance would leave a preference for death benefits provided by many employers under pension plans as substitutes for life insurance. Employees can defer income tax and pay no payroll tax on employer contributions to pension plans. Also, the first $5,000 of employee death benefits are tax-exempt. If the Congress made employer-paid life insurance plans taxable, employers might choose to offer less life insurance and larger death benefits on pension plans instead.

REV-12 DECREASE LIMITS ON CONTRIBUTIONS TO QUALIFIED PENSION AND PROFIT-SHARING PLANS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Decrease Limits for Defined Benefit Plans to the Social Security Wage Base (With equivalent reductions for defined contribution plans)	0.5	1.5	1.4	1.4	1.4	6.2
Decrease the Limit for Deferrals in Salary Reduction Plans to $4,000	0.4	0.5	0.7	0.7	0.8	3.1

SOURCE: Joint Committee on Taxation.

Saving for retirement through employer-provided qualified pension and profit-sharing plans provides two tax advantages: it exempts from taxes the investment income earned by the assets in qualified plans, and it defers tax on employer contributions to qualified plans until retirement, when an employee's marginal tax rate is often lower.

Decrease Limits on Employer Contributions. Section 415 of the tax code establishes limits on the benefits that an employer can fund in qualified plans for any employee. The limits depend on the type of plan the employer offers.

Defined contribution plans specify how much the employer will contribute for each employee's retirement--for example, 5 percent of pay. The employee's pension depends on how much the employee's retirement fund accumulates by the time he or she retires. Current law limits annual contributions to such plans to 25 percent of compensation or $30,000, whichever is less.

Defined benefit plans specify the pension amount employees will receive in retirement, which is usually a percentage of preretirement earnings. Employers adjust their annual contributions so that enough will accumulate by the time the employee retires to pay the promised pension. Current law limits contributions to defined benefit plans so that annual benefits for pensions that begin at age 65 are no more than 100 percent of preretirement wages or $120,000 for 1995, whichever is less. The tax law reduces that limit on an actuarial basis for pensions that begin at an earlier age. When an employer sponsors both types of plans, a higher limit applies--the lesser of 140 percent of wages or $150,000 for 1995.

The limits on employer contributions are intended to limit the size of the tax benefits received by highly paid people. Those people are better able to provide adequately for retirement without the full tax benefits and may use pensions to shelter nonretirement savings from taxation. Furthermore, providing full tax benefits for these people would reduce the progressivity of the tax code.

The main argument for lowering the current limits on contributions is that they allow the funding of pensions far higher than the preretirement earnings of most workers. Three percent of people who worked full time throughout 1993 earned as much as $100,000. Yet current limits allow the funding of pensions up to $120,000. Workers who accrue pen-

sions that large are unlikely to need the full tax advantage to provide adequately for their retirement. Limiting funding for defined benefit plans to amounts necessary to pay benefits equal to the Social Security wage base ($61,200 in 1995), and making proportionate reductions in limits for defined contribution plans, would raise about $6 billion from 1996 through 2000 because more employment income would be subject to taxes. Those limits would still be higher than the earnings of all but about 9 percent of full-time workers.

One argument against reducing funding limits is that it would make participation less attractive to high-income business owners and top managers and thus might discourage them from sponsoring those plans for both themselves and their employees. Although the higher-paid managers and owners might not need tax-advantaged pension plans to save adequately for retirement, their employees might. A further argument against reducing the limits is a concern that national saving is too low. Limiting incentives for pension saving could reduce total saving.

Limit 401(k) Deferrals to $4,000. Section 401(k) of the tax code allows employees to choose to receive lower current (taxable) compensation and defer the remainder of compensation as a contribution to an employer retirement plan. Similar arrangements are possible for some workers in the nonprofit sector (403(b) tax-sheltered annuities), federal workers, and workers enrolled in some simplified employer plans (SEPs).

Section 402(g) specifies indexed limits for employee deferrals. In 1995, the limit for deferrals to 401(k) plans, SEPs, and the federal plan is $9,240. A temporarily higher limit of $9,500 exists for tax-sheltered annuities authorized under section 403(b). Limiting deferrals in all plans with cash or deferred arrangements to $4,000 in 1996, and indexing that limit thereafter, would raise about $3 billion in 1996 through 2000.

Lowering the limit would affect higher-income workers who are likely to provide adequately for their own retirement without the tax incentive. In addition, many employers have added 401(k) plans on top of other pension plans that already meet the basic retirement needs of employees. The 401(k) plans provide supplementary saving for those who prefer higher retirement income. Thus, limiting contributions to 401(k) plans would not threaten the basic retirement security of those workers.

Alternatively, higher limits provide a greater incentive for employers to initiate the plans, which benefit employees at all income levels. In particular, 401(k) plans appeal to small employers who have traditionally not established pension plans. Lower limits may discourage small employers from offering what could be the only retirement benefit available to their employees. Lowering limits on those plans and not on other plans encourages traditional pensions, which are primarily defined benefit plans. Unlike defined benefit plans, 401(k) plans and other defined contribution plans do not discriminate against workers who change employers or drop out of the workforce temporarily. In addition, the voluntary nature of plans with cash or deferred arrangements allows workers who have spouses without coverage to save more for retirement than other workers.

Recent Change in Other Funding Limit. In addition to the section 415 and section 402(g) limits described above, section 401(a)(17) limits the amount of compensation that can be considered in calculating an employee's benefits. The Omnibus Budget Reconciliation Act of 1993 reduced that compensation limit from $235,840 in 1993 to $150,000 in 1994 and provided for indexing the limit in subsequent years. The reduction was estimated to raise $2.5 billion between 1994 and 1998.

The limits in section 415 and section 402(g) primarily restrict pension benefits for high-income employees with generous pension plans. The compensation limit primarily restricts pension benefits for all high-income employees.

REV-13 IMPOSE A 5 PERCENT TAX ON INVESTMENT INCOME OF PENSION PLANS AND INDIVIDUAL RETIREMENT ACCOUNTS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	7.3	12.1	12.9	13.6	14.3	60.2

SOURCE: Joint Committee on Taxation.

Under normal income tax rules, the interest earnings of savings accounts are fully taxable each year. The absence of that annual tax is one of the tax advantages for employer pensions and individual retirement accounts (IRAs). Instituting a tax at a low rate on the earnings of pension funds and IRAs would reduce the size of that advantage. A 5 percent tax rate would raise about $60 billion between 1996 and 2000. (The other tax advantage of pensions and IRAs is the deferral of tax on contributions until retirement, when an employee's marginal tax rate is often lower.)

The tax advantages for pensions and IRAs encourage firms and workers to provide for retirement. Most studies of pensions find that they increase saving; the studies of IRAs are less conclusive. Although the tax advantages promote a public objective, many people receive little or no benefit from them. Only about half of employees receive pension coverage or contribute to IRAs. The largest pension benefits go disproportionately to higher-paid workers or to workers with long-term employment at large firms.

Imposing a tax at a low rate on pension and IRA earnings would reduce the tax advantage of saving for retirement through those vehicles. Such a tax would reduce the use of pensions and IRAs slightly and probably result in less retirement saving. The smaller tax advantage for pensions and IRAs would, however, make the tax burden between employees with pensions and IRAs and those without them slightly more equal. It would also increase taxes relatively more for higher-paid workers.

Taxing pension and IRA earnings would affect more taxpayers than would setting lower limits on employer contributions to pension plans (see REV-12). Lowering the contribution limits would increase taxes on a small number of the highest-paid workers, and would increase taxes substantially for some of them. Taxing pension and IRA earnings would affect workers throughout the income distribution. Moreover, because it would affect so many more workers, it could raise more revenue with a smaller impact for each employee who pays more tax.

Taxing the annual earnings of pension funds and IRAs would encourage fund managers to shift their investments toward assets that appreciate in value, such as growth stocks and real estate, because they can defer tax on capital gains until realization (see REV-22). To obtain that tax deferral, however, pension funds would have to invest in riskier assets. Although that portfolio shift would reduce the security of workers' retirement funds, it would make it easier for risky enterprises to obtain funding.

REV-14 TAX THE INCOME-REPLACEMENT PORTION OF WORKERS' COMPENSATION AND BLACK LUNG BENEFITS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	1.4	4.0	4.1	4.2	4.3	18.0

SOURCE: Joint Committee on Taxation.

Current law exempts workers' compensation and Black Lung benefits from income taxation. Taxing the portion of those benefits that replaces the income employees lose from work-related injuries or black lung disease would increase revenues by $18 billion from 1996 through 2000. The remaining portion, which reimburses employees for medical costs (about 40 percent), would continue to be exempt from taxation.

Taxing the income-replacement portion of workers' compensation and Black Lung benefits would make the tax treatment of those entitlement benefits comparable to the treatment of unemployment benefits and the wage-replacement benefits that employers provide through sick pay and disability pensions. It would also improve work incentives for disabled workers who are able to return to work. (Under current law, the after-tax value of the wages they are able to earn may be less than the tax-free benefits they receive while disabled.)

An argument against taxing such benefits is that legal or insurance settlements for non-work-related injuries are not taxable, even if a portion of them reimburses lost income. Hence, taxing workers' compensation benefits would treat those two types of compensation inconsistently.

Furthermore, to the extent that the current levels of wage-replacement benefits were established under the assumption that they would be untaxed, this option would reduce benefits below desired levels. Enacting the option, therefore, might lead to efforts to increase benefits.

REV-15 INCREASE TAXATION OF SOCIAL SECURITY AND RAILROAD RETIREMENT BENEFITS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Tax 85 Percent of Benefits for All Recipients	8.3	21.1	21.9	22.8	23.7	97.8
Tax 85 Percent of Benefits for Recipients with Income Above \$44,000 (Couples) and \$34,000 (Individuals) and Tax 50 Percent of Benefits for All Other Recipients	4.0	10.2	10.6	11.0	11.4	47.2
Tax 85 Percent of Benefits for Recipients with Income Above \$32,000 (Couples) and \$25,000 (Individuals)	0.4	0.8	0.9	0.9	1.0	4.0

SOURCE: Joint Committee on Taxation.

Social Security and Railroad Retirement (Tier I) together constitute the federal government's largest entitlement program. Most benefits are not subject to tax. Under current law, a taxpayer first calculates his or her combined income, which is the sum of adjusted gross income (AGI), nontaxable interest income, and one-half of Social Security and Tier I benefits. If a taxpayer's combined income exceeds a fixed threshold, he or she includes a fraction of benefits in AGI. The thresholds at which up to 50 percent of benefits are subject to tax are \$25,000 for single returns and \$32,000 for joint returns. About 22 percent of households receiving Social Security benefits pay income tax on those benefits. Because the thresholds remain fixed over time, as nominal incomes increase, the percentage of households that pay tax on benefits will grow to 27 percent in 2000.

The Omnibus Budget Reconciliation Act of 1993 (OBRA-93) increased the fraction of Social Security and Tier I benefits subject to tax for higher-income taxpayers by adding new income thresholds, \$34,000 (single) and \$44,000 (joint), above which up to 85 percent of benefits become subject to tax. OBRA-93 allocated the additional revenues from this change to the Medicare trust fund. All other revenues from taxing Social Security benefits go to the Social Security retirement and disability trust funds. H.R. 8, a bill introduced in 1995 and based on a proposal in the Contract with America, would repeal the changes to the taxation of Social Security and Railroad Retirement benefits that the Congress enacted in OBRA-93.

Couples with income below \$32,000 and individuals below \$25,000 currently pay no tax on their benefits. Options one and two expand the population of beneficiaries subject to tax. Options one and three increase the fraction of benefits subject to tax to 85 percent for taxpayers currently taxed on up to 50 percent of their benefits. None of the options affect taxpayers currently subject to tax on 85 percent of their benefits.

Increasing the percentage of benefits that are taxable from 50 percent to 85 percent would make the treatment of Social Security roughly similar to that of contributory pension plans. Workers receiving benefits from contributory plans pay income tax on the excess of benefits over their own contributions. Social Security actuaries estimate that among workers now entering the labor force, payroll taxes will represent 15 percent of expected benefits for high-earning,

unmarried workers and a lower percentage for all other workers. Thus, 85 percent is the minimum fraction of benefits in excess of past contributions. However, a lower rate might be appropriate for two reasons. First, benefits will have to be cut or taxes raised at some point in the future to restore the long-run balance of Social Security. Either change would raise taxes as a share of benefits above 15 percent for some workers. Second, keeping the inclusion rate at 50 percent would make the treatment of Social Security equivalent in terms of present value to that of noncontributory pensions, the more common form of pension.

Increasing the tax on benefits would reduce the net benefits of retirees compared with what some people consider to be the implicit promises of the Social Security and Railroad Retirement programs at the time recipients were working. The government has, however, made numerous changes in the Social Security and Railroad Retirement programs over time, including changing the benefit formula, introducing partial taxation of benefits, and raising payroll tax rates to finance the programs.

The first option would eliminate the income thresholds entirely and would require all beneficiaries to include 85 percent of their benefits in their adjusted gross income. It would raise nearly $100 billion from 1996 through 2000. Eliminating the income thresholds would cause many more, but not all, Social Security recipients to pay income tax on their benefits. In addition to the thresholds, the tax code protects lower-income elderly households from taxation of income through personal exemptions, the regular standard deduction, and an additional standard deduction for the elderly. Under current law, 22 percent of elderly couples and individuals with benefits pay income tax on their benefits. Eliminating the thresholds on taxing benefits would raise the share of couples and individuals paying tax on their benefits to 68 percent.

Eliminating the thresholds would reduce tax disparities among middle-income households. Social Security beneficiaries receive a tax preference not available to other taxpayers because they can exclude a portion of their income--Social Security benefits below the thresholds--from AGI. As a result, the average income tax rate that middle-income elderly families pay is less than the tax rate that nonelderly families with comparable income pay under current law.

The second option would not change the treatment of couples with combined income above $44,000 and individuals with combined income above $34,000--they would still be taxed on up to 85 percent of their benefits--but would require all other recipients to include 50 percent of benefits in their adjusted gross income. This option would raise $47.2 billion from 1996 through 2000. Couples with combined income below $32,000 and individuals with combined income below $25,000 would be added to the beneficiaries whose benefits are subject to tax. Almost all beneficiaries currently taxed on up to 50 percent of their benefits--couples with combined income between $32,000 and $44,000 and individuals with combined income between $25,000 and $34,000--would be unaffected. (Because the taxation of benefits is phased in under current law, some couples with combined income just above $32,000 and singles with income just above $25,000 are now taxed on less than a full 50 percent of their benefits.)

The final option would keep the current-law income threshold of $32,000 for couples and $25,000 for individuals, while including up to 85 percent of benefits for all taxpayers above that threshold. The option would raise $4 billion from 1996 through 2000. It would, moreover, almost exclusively affect couples with combined income between $32,000 and $44,000, and individuals with income between $25,000 and $34,000.

Increased taxation of Social Security benefits is one way to apply some type of means test to those benefits. As an alternative to expanding taxation, the government can reduce benefits from those programs by changing the benefit formula (see ENT-59 through ENT-62), reducing cost-of-living adjustments (see ENT-67), or including benefits in a broadly based means test of multiple entitlement programs (see ENT-68).

REV-16 TAX INVESTMENT INCOME FROM LIFE INSURANCE AND ALL ANNUITIES

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	4.5	12.9	16.8	20.6	23.2	78.0

SOURCE: Joint Committee on Taxation.

Life insurance policies often combine features of both insurance and tax-favored savings accounts. In the early years of whole life insurance and similar policies, annual premiums exceed the annual cost of insurance. As the excess premiums accumulate, they earn investment income, which is then available to pay the cost of future insurance, provide part of a death benefit, or provide a disbursement to the policyholder if the policy is voluntarily canceled.

The investment income, sometimes called "inside buildup," receives special tax treatment under current law compared with the interest income from other investments. It is exempt from taxation when used to pay the cost of future life insurance. It is also tax-exempt to the beneficiary or, with some tax planning, to the estate of the insured person when it is paid as part of a death benefit. The accumulated investment income is taxable to the policyholder when he or she voluntarily cancels a policy and receives a disbursement. Even when the investment income is ultimately taxable, however, the tax deferral can be favorable to the policyholder. The interest income from other investments, such as taxable bonds, is subject to tax as it accrues, even when interest is not paid to the investor until the bond matures.

Life insurance companies also sell annuities, which likewise have features of both insurance and tax-favored savings accounts. Life annuities promise periodic payments to the annuitant as long as he or she lives. Those payments provide insurance against the possibility that the annuitant will outlive his or her assets. By nature, however, annuities are also saving vehicles because annuity premiums are paid in return for annuity benefits received at a later date. Because premiums are often paid long before benefits are received, the benefits must include a return on investment in order for an annuity to be financially attractive.

For tax purposes, annuity benefits are divided into two parts--a return of principal and investment income. Only the investment income is subject to tax. Although investment accrues over the life of a contract, it is not included in taxable income until benefits are paid. As with whole life insurance and other similar policies, such tax deferral can increase the after-tax return to the investor significantly compared with alternative investments such as taxable bonds and certificates of deposit, from which interest income is taxable as it accrues.

Tax Investment Income Annually. Under this option, policyholders would include the investment income from life insurance policies and annuities in taxable income as it accrued. Insurance companies would report the accrued investment income to a policyholder or annuitant annually. Life insurance disbursements and annuity benefits would no longer be taxable as they were paid. Investment income from annuities purchased as part of a qualified pension plan or qualified individual retirement account would still be tax-deferred until benefits were paid. Making the investment income taxable in that way would raise $78 billion in 1996 through 2000.

Taxing the investment income from life insurance and annuities would equalize their tax treatment with the tax treatment of similar investments. The investment income from life insurance and annuities is tax-deferred, but the income from an ordinary sav-

ings account or taxable bond is taxed as it accrues. Alternatively, the tax deferral for life insurance and annuities is consistent with the tax deferral currently allowed for capital gains income.

A tax incentive to purchase life insurance is desirable if people systematically underestimate the financial hardship on spouses and families caused by their own death. Such shortsightedness could cause them to buy too little life insurance. Similarly, it might cause people to buy too little annuity insurance to protect them against outliving their assets. But it is not currently known whether people would buy too little insurance without the tax incentive, or the extent to which the tax incentive increases the amount of life insurance or annuity coverage. If the incentive is justified to correct for people's shortsightedness rather than subsidize the inside buildup, a better policy might be to subsidize life insurance directly by allowing a tax credit or partial deduction for insurance premiums. Annuities receive other tax incentives through the special tax treatment of pensions and retirement savings.

A tax preference for inside buildup in life insurance policies and annuities might encourage saving. The tax preference might increase saving because it increases people's income when they are older for each dollar they save when they are younger. The tax preference might, however, reduce saving because it also enables people to save less when they are younger without reducing their expected income when they are older. The net effect on saving is uncertain.

A More Limited Option. Some annuity contracts sold by life insurers provide little or no insurance against outliving assets. For example, a contract may guarantee to pay a minimum total benefit regardless of how long the annuitant lives. Other annuities simply make predetermined benefit payments over a fixed term. Such "term-certain" annuities are simply investments and are essentially identical to bonds, bank certificates of deposit, or money market mutual funds.

Under a more limited option, an individual's taxable income would include the annual accrual of investment income only from annuity benefits that are guaranteed to exceed a certain amount or to be paid over a fixed period, regardless of how long the annuitant lives. The insurance companies would annually report to individuals the amounts to be included as taxable income. To lessen the burden of compliance, however, no reporting or accrual taxation would be required when the term-certain portion of the value of an annuity accounted for less than one-third of its value. Annuities purchased as part of a qualified pension plan or qualified individual retirement account would also be exempted. This option is similar to a proposal by the Bush Administration in its 1993 budget. An estimate of the option's budgetary effect is not currently available.

REV-17 TAX A PORTION OF THE INSURANCE VALUE OF MEDICARE BENEFITS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
			With Income Thresholds			
Tax Hospital Insurance Only	1.9	5.0	5.7	6.4	7.2	26.2
Tax Supplementary Medical Insurance Only	1.0	2.8	3.3	3.9	4.5	15.5
Tax Both	3.2	8.4	9.7	11.1	12.8	45.2
			Without Income Thresholds			
Tax Hospital Insurance Only	2.7	9.3	10.2	11.2	12.3	45.7
Tax Supplementary Medical Insurance Only	1.4	4.8	5.6	6.4	7.3	25.5
Tax Both	4.5	15.6	17.4	19.5	21.8	78.8

SOURCE: Joint Committee on Taxation.

Like Social Security, Hospital Insurance (HI) benefits under Medicare are financed by payroll taxes that are earmarked for a trust fund. Social Security benefits, however, are partially taxable for higher-income people, whereas the value of HI benefits is not subject to tax. In addition, the Supplementary Medical Insurance (SMI) component of Medicare is heavily subsidized; premiums cover only about 25 percent of the benefits paid. This option would tax HI the same way Social Security is taxed under current law or under the tax option in REV-15 and would partially tax SMI.

The first option would treat the insurance value of Medicare like Social Security benefits, although the tax would be imposed on the average insurance value of in-kind Medicare benefits, not on the dollar value of benefits actually received. In this option, 85 percent of the value of HI and 75 percent of the value of SMI would be included in adjusted gross income (AGI) for taxpayers with combined income (AGI plus nontaxable interest income plus one-half of Social Security, Railroad Retirement, and Medicare benefits) over $34,000 for single returns and $44,000 for joint returns. For taxpayers with combined income below those thresholds but above $25,000 (single) and $32,000 (joint), 50 percent of the insurance value of both HI and SMI would be included in AGI. Taxpayers with lower income would have no additional tax liability. Because the thresholds are fixed, inflation would cause a larger fraction of Medicare insurance benefits to become taxable over time.

With those income thresholds, the HI tax alone would increase federal revenues by about $26 billion from 1996 through 2000. The SMI tax alone would yield about $16 billion over the five-year period. If both taxes were imposed simultaneously, revenues would be about $45 billion higher over five years. The combined tax would generate more revenues than the sum of the HI and SMI taxes because some taxpayers would be subject to higher tax rates as a result of the increase in AGI. In addition, more enrollees would have income above the threshold when both components are included.

The second option would include 85 percent of the insurance value of HI benefits and the subsidy component of SMI (about 75 percent) in AGI for all taxpayers. Without an income threshold, the HI tax alone would increase federal revenues by about $46 billion over the 1996-2000 period. Revenues from

the SMI tax alone would be about $25 billion over the five-year period. If both taxes were imposed simultaneously, revenues would be nearly $79 billion higher over the five-year period.

Earmarking revenues from taxing HI benefits for the HI trust fund would delay the projected deficit of the trust fund in 2003. A tax on SMI benefits would shift some SMI costs from taxpayers to enrollees. If income thresholds were used, lower-income enrollees would not be affected. In fact, this proposal would affect only about 57 percent of enrollees in 1996 even if no income thresholds were used. Furthermore, since this option would use the mechanism already in place for taxing Social Security benefits, it would be straightforward to administer.

Unlike the tax on Social Security benefits, this tax would be imposed on the insurance value of in-kind benefits rather than on the dollar benefits actually received. Some people might object that the additional income does not generate cash with which to pay the tax liability. (There would be little to recommend basing the tax on actual benefits received, however, because it would then be directly related to enrollees' health care costs. Such a tax would reduce the insurance protection Medicare is intended to provide.) In addition, the actual value of insurance provided under Medicare varies among households based on age, health status, and whether they have other health insurance.

Thus, including a fixed imputed HI premium in income might be viewed as unfair. The approximately 13 percent of enrollees in or above the 28 percent tax bracket would face a tax increase averaging about $1,250 in 1996 for individuals and about $2,520 for couples with two enrollees, assuming the combined tax was imposed with no income thresholds. In addition, more households would have to pay tax on Social Security benefits if the definition of combined income was expanded to include Medicare benefits.

REV-18 EXPAND MEDICARE AND SOCIAL SECURITY COVERAGE

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Expand Medicare Coverage to Include State and Local Government Employees Not Now Covered	1.1	1.6	1.5	1.5	1.4	7.1
Expand Social Security Coverage to Include All New State and Local Government Employees	0.3	1.0	1.8	2.7	3.5	9.3

SOURCE: Congressional Budget Office.

NOTE: These estimates do not include the effect of any increases in benefit payments that would result from the option. They would be small over this five-year period. Estimates are net of reduced income tax revenues.

Certain groups of federal, state, and local government workers are not covered under the Medicare and Social Security programs, despite recently expanded coverage. Legislation in the past decade required all federal workers to pay Medicare payroll taxes beginning in 1983 and required federal employees who began work after December 31, 1983, to pay Social Security payroll taxes. Further legislation mandated that state and local workers who began employment after March 31, 1986, pay Medicare payroll taxes. The Omnibus Budget Reconciliation Act of 1990 expanded Social Security and Medicare coverage to include state and local government workers not covered by any retirement plan.

Under current law, many state and local employees will qualify for Social Security and Medicare benefits based on other employment in covered jobs or their spouse's employment. Those workers will thus receive benefits in return for a smaller amount of lifetime payroll taxes than are paid by people who work continuously in covered employment. That inequity is especially apparent for Medicare benefits: one out of six state and local employees is not covered through his or her employment, but 85 percent of those employees receive full Medicare benefits through their spouse or because of prior work in covered employment. Inequitable treatment is less of a problem in the case of Social Security benefits because the benefit formula is adjusted for retired government workers who have worked a substantial portion of their career in employment not covered by Social Security.

Requiring all state and local workers to pay Medicare payroll taxes, and all new state and local workers to pay Social Security payroll taxes, would make coverage of state and local workers resemble that of federal workers. That broader coverage would reduce the inequity from the high benefits those workers receive in relation to payroll taxes paid. Expanding Medicare and Social Security payroll taxes to include more state and local workers would increase the government's liability for future program benefits. The additional revenues, however, would most likely more than offset increased benefits permanently.

Expand Medicare Coverage to Include State and Local Government Workers Not Now Covered. Expanding Medicare coverage to include state and local government workers who began work before April 1, 1986, would raise $7.1 billion from 1996 through 2000. The annual revenue gain would decline gradually over time, coinciding with the number of workers who were hired before April 1986

and remained on payrolls of state and local governments. The Administration proposed this option in its health care reform package of 1993, and in recent years, the Congress has considered it during the budget reconciliation process.

Expand Social Security Coverage to Include All New State and Local Government Workers. Retirement coverage for state and local government workers may be provided by a public-employee program, the Social Security program, or a plan that integrates the two programs. Expanding Social Security coverage to include all new state and local government workers would raise $9.3 billion from 1996 through 2000, although in the long run higher Social Security benefit payments would offset a portion of the extra revenue. The annual revenue gain would grow rapidly--to $3.5 billion by 2000--because the pool of new employees would grow rapidly.

How states and localities revised their pension plans in response to mandatory coverage would determine which workers gained and lost from this change, but requiring coverage of new state and local government workers would be likely to benefit many workers who spent only part of their career in the government sector. First, because of the portability of coverage, newly hired workers would find it easier to qualify for disability and survivors' benefits under Social Security than under many public-employee benefit programs. Second, Social Security eligibility is not lost if the state and local employees change jobs before they are vested. Third, Social Security benefits are calculated on the basis of indexed wages, whereas benefits from public pension plans are calculated on the basis of nominal wages for a given amount of covered wages. Consequently, workers who worked only when they were young would receive more generous retirement benefits from Social Security than from public pension plans.

State and local governments would have to pay the employer's share of Social Security taxes on new employees if coverage was made mandatory. Because state and local government participation in Social Security is now voluntary, those states with a low percentage of covered employees would bear more of the cost of expanded mandatory coverage, including the cost of setting up the system.

REV-19 CURTAIL TAX SUBSIDIES FOR EXPORTS

	Annual Added Revenues (Millions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	2.5	4.2	4.5	4.8	5.2	21.2

SOURCE: Joint Committee on Taxation.

The tax code subsidizes U.S. exports in two important ways. First, the allocation of income between domestic and foreign business activities under the "title passage" rule routinely allows U.S. multinational companies to use excess foreign tax credits to offset about half of the U.S. tax on their export income by characterizing it as foreign-source income. Second, the tax rules for foreign sales corporations (FSCs) offer U.S. companies an opportunity to exempt about 15 percent of their export income from U.S. tax by characterizing it as income of a foreign subsidiary that is not effectively connected with U.S. trade or business.

Sourcing Rules for Sales of Inventory. U.S. companies generally pay U.S. tax on their worldwide income, but they may claim a foreign tax credit. The foreign tax credit reduces the tax that U.S. companies owe on foreign-source income by the amount of income tax they pay abroad. To prevent the foreign tax credit from offsetting domestic-source income, the tax code limits the credit to the amount of tax owed on foreign-source income. When foreign tax payments exceed the U.S. tax on foreign-source income, U.S. companies accrue excess foreign tax credits that they cannot currently use. U.S. companies retain those excess credits to offset taxes owed on future income from foreign sources, but only for five years. (One consequence of lowering corporate tax rates in the Tax Reform Act of 1986 is that more U.S. multinational companies are accumulating excess foreign tax credits that are likely to expire.)

In allocating worldwide income between domestic and foreign sources, sourcing rules determine how fully U.S. companies can use their foreign tax credits to reduce their U.S. tax liability. For example, when a corporation has excess foreign tax credits, treating a dollar of income as foreign-source income instead of domestic-source income allows the corporation to use excess credits that might otherwise expire to reduce the U.S. tax on its worldwide income by about 35 cents.

Sales income is classified for tax purposes as domestic or foreign source according to a complex set of sourcing rules that take account of the residence of the seller, the place of sale, the location of the seller's business activities, and the presence of any foreign tax on the sales income. Under a particular rule known as the "title passage" rule, the income of a U.S. company from the sale of inventory is sourced according to the place of sale. So when inventory is sold abroad, the income from the sale is deemed foreign-source income, regardless of where the inventory was purchased and regardless of whether the income was subject to foreign tax. When a U.S. company produces the inventory in the United States and markets it abroad, half of the income is typically classified as foreign source on the basis of the title passage rule and half is classified based on the location of the production activity. Assuming the company has excess foreign tax credits to offset the tax on its foreign-source income, the 50-50 allocation effectively exempts half of the export income from U.S. tax.

If the title passage rule allows a company with excess foreign tax credits to classify more of its export income as foreign source than it could justify solely on the basis of the location of its business activities, then the company receives an implicit export subsidy.

Foreign Sales Corporations. According to a decision by the governing council of the General Agreement on Tariffs and Trade (GATT), export income can be exempt from U.S. tax only if the economic activity that produces the income takes place outside the United States. In response to the GATT decision, the tax code was amended by the Congress to allow U.S. companies to charter FSCs in low-tax countries and either supply goods to the FSCs for resale abroad or pay commissions to FSCs on export sales. Although the FSCs are largely paper corporations with very few employees, the Congress believes that they have enough foreign presence and economic substance to meet GATT's requirements to exempt export income.

Under the tax code, when a U.S. company sells exports through an FSC, about 23 percent of the total income from production and marketing is attributed to the FSC and about 65 percent of the FSC's export income is exempt from U.S. tax. The exempt income, which is approximately 15 percent of the income from the sale, remains free from U.S. tax when the U.S. company receives it as a dividend from the FSC.

Economic Effects of Export Subsidies. Export subsidies increase investment and employment in export industries, but do not increase the overall levels of domestic investment and domestic employment. Stimulating exports increases the demand for U.S. dollars by foreigners, which raises the value of the dollar and lowers the cost of imports, causing imports to increase. In the long run, export subsidies increase imports as much as exports, which causes investment and employment in import-competing industries in the United States to decline about as much as they increased in the export industries.

Export subsidies reduce domestic welfare by distorting the allocation of economic resources at home and abroad. The subsidized production of export goods in the United States partially displaces the more efficient production of those goods abroad. Moreover, the subsidies increase the worldwide supply of goods that the United States exports and decrease the worldwide supply of goods that the United States imports. The shifts in supply lower the world price of U.S. exports and raise the price of U.S. imports. As a result, domestic welfare suffers because the United States receives fewer import goods in exchange for its export goods.

Curtailing the export subsidies provided by the title passage rule and the favorable tax treatment of FSCs would raise about $21 billion from 1996 through 2000. The option would curtail the export subsidy from the title passage rule by eliminating it and treating the income of U.S. companies from the sale of goods abroad as domestic-source income. An exception would be allowed, however, if a U.S. company had a place of business that was located outside the United States and was substantially involved in the export sale. Under the exception, income would be allocated between domestic and foreign sources based on the location of the business activities that produced the income. The option would curtail the subsidy from FSCs by treating them like other foreign subsidiaries. In general, all of the income repatriated from FSCs would be subject to U.S. tax, but some of it might be foreign-source income under the revised sourcing rule mentioned above. The tax on any income from the FSC that was deemed foreign-source income could be offset by unused foreign tax credits.

REV-20 IMPOSE A MINIMUM TAX ON FOREIGN-OWNED BUSINESSES

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	0.2	0.3	0.4	0.5	0.5	1.9

SOURCE: Joint Committee on Taxation.

Foreign-owned companies must pay tax on the income they earn from business activities within the United States. Treaties with other countries generally stipulate that the United States will not tax the income of foreign-owned businesses more heavily than the income of U.S.-owned businesses.

When foreign multinational corporations operating in the United States import materials and services from affiliated companies abroad, the "transfer price" of imports affects the amount of income that is subject to U.S. tax. (The transfer price is the price charged for goods sold between affiliated companies.) By raising the transfer price of imports, foreign-owned companies can shift income out of the United States to their foreign affiliates and reduce their U.S. tax liability. U.S. tax law requires companies to base the transfer prices of many goods and most services on comparable transactions between unaffiliated companies. But such prices are often difficult for companies to determine and even more difficult for the Internal Revenue Service to enforce, especially when comparable goods and services are not routinely traded between unaffiliated companies.

Foreign-owned multinational corporations may be manipulating transfer prices to shift income overseas and avoid U.S. tax. Circumstantial evidence has indicated that this kind of tax avoidance has occurred. For example, studies have found that the reported profit rates (as a percentage of assets and as a percentage of sales) of foreign-owned multinational corporations operating in the United States are generally lower than the profit rates of U.S.-owned corporations in the same industry. However, other plausible explanations exist for the low profit rates. For example, foreign-owned companies may have newer plants and equipment than U.S.-owned companies in the same industry. Because accelerated depreciation methods allow companies to claim larger annual deductions on newer equipment than on older equipment, foreign-owned companies would have higher reported depreciation costs and lower reported profit rates as a percentage of sales. Moreover, because the absence of an inflation adjustment for the book value of plant and equipment undervalues older assets relative to newer assets, U.S.-owned companies with older assets would tend to have higher profit rates as a percentage of reported book value than foreign-owned companies with newer assets.

To discourage foreign companies from manipulating transfer prices to avoid U.S. tax, a minimum tax could be levied on foreign-owned businesses that have a sizable amount of trade with affiliated companies overseas. One legislative provision, introduced in 1992, would have imposed a minimum tax on all companies that are at least 25 percent foreign owned and have transactions with foreign affiliates in excess of either 10 percent of their gross income or $2 million annually. Under the proposal, the foreign-owned company would compute its taxable income under the current income tax rules, but its taxable income would be subject to a floor. The floor would equal 75 percent of its gross business receipts multiplied by the average profit margin on gross receipts for U.S. companies in the same industry. If the foreign-owned company's operations spanned several industries, the floor would be based on the profit margins in each industry weighted by the share of the company's gross receipts in that industry. The Internal Revenue Service could waive the minimum tax after examining a company's method of computing transfer prices and finding it acceptable.

The formula approach under the minimum tax provides a simple way to ensure that foreign-owned companies conducting business in the United States pay an acceptable amount of U.S. tax. The simplicity of the approach may offer some advantage over the cumbersome rules for arm's-length pricing, which are extremely difficult to enforce. The formula approach, however, provides a very crude estimate of taxable profit.

The minimum tax would discriminate against foreign-owned companies, possibly in violation of U.S. treaties, by taxing their income more heavily than the income of their domestic competitors. The minimum tax would be especially onerous on foreign-owned companies starting new businesses in the United States because new businesses are seldom profitable initially. Under the minimum tax, such businesses would still owe a sizable amount of income tax based on their gross receipts.

Other countries would be likely to treat the minimum tax as a protectionist measure and retaliate with similar taxes on U.S.-owned companies conducting business within their borders. If so, the minimum tax would stifle international trade and reduce economic welfare throughout the world. Imposing the minimum tax on foreign-owned companies, which is one of many possible formulary approaches, would raise almost $2 billion from 1996 through 2000.

REV-21 TAX CAPITAL GAINS FROM HOME SALES

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Tax 30 Percent of Gain	3.6	5.5	5.4	5.6	5.8	25.9
Tax Lifetime Gains in Excess of $125,000	0.2	0.4	0.4	0.4	0.4	1.8

SOURCE: Joint Committee on Taxation.

When homeowners sell their home, they realize a capital gain or loss equal to the difference between the selling price and their basis. Their basis is the initial cost of the home plus the cost of home improvements.

Although capital gains on most assets are taxable when the assets are sold, capital gains on home sales generally escape taxation. A taxpayer can defer the capital gain from the sale of a principal residence if she or he purchases another home of at least equal value within two years. When a homeowner dies, the accrued gain on the current home plus any gain on previous homes escapes tax permanently. Further, the tax law allows taxpayers age 55 and older to exclude up to $125,000 of gain from one home sale even if they do not purchase another home of equal or greater value within two years. Replacing the above provisions with a rule that includes 30 percent of capital gains from home sales in taxable income would raise $25.9 billion in 1996 through 2000. Alternatively, including all lifetime gains in excess of $125,000 in taxable income when realized would raise $1.8 billion over the same period.

The preferential treatment of capital gains from home sales is only one of the ways in which the tax code strongly favors owner-occupied homes over other investments (for a discussion of other ways, see REV-04). All of these tax preferences divert savings from business investment to housing. One way to make the tax treatment of housing more like that of other assets would be to replace the capital gains deferral and exclusion provisions with a low tax rate on gains from home sales. Including 30 percent of the gain from home sales in taxable income would make the tax rate on such gains range from 4.5 percent for taxpayers facing a 15 percent marginal tax rate to 11.9 percent for those in the 39.6 percent tax bracket.

A tax on gains from home sales would discourage home sales in the same way that current law discourages taxpayers from selling other capital assets. In the case of home sales, that might discourage workers from relocating to take advantage of better job opportunities. The tax might also deter some homeowners (especially older taxpayers with large accrued gains) from changing homes as family requirements change.

Another option would allow all taxpayers to exempt the first $125,000 of gains on all home sales from tax, while fully taxing the excess over that amount at the time of sale. This option would protect the mobility of most homeowners. Taxpayers who realize a gain of less than $125,000 on their first home could apply the unused portion to future home sales. That exclusion would increase the mobility of homeowners under age 55 relative to current law because they could move to homes of lesser value without incurring a tax as long as the gain on the home they sold was less than $125,000. Although this proposal would increase mobility for most homeowners, it would reduce it for those under age 55 whose gains from home sales exceed $125,000. Those taxpayers could no longer defer additional gain by purchasing a more expensive home.

Taxing gains on home sales without the rollover and exclusion that current law allows would increase

the need for taxpayers to keep records of home improvements. They would need to maintain such records to establish the tax basis of a home upon sale. Currently, many taxpayers do not keep such records because the probability of any future tax on gains from a home sale is low and the expected present value of such a tax is small. Allowing a lifetime exemption of $125,000 would complicate recordkeeping, especially when people buy and sell successive homes with different spouses.

Much of the capital gain on home sales results from inflation. Inflationary gains are not income and therefore ideally would not be subject to income taxation. Taxing inflationary gains may, however, be an appropriate way to offset the tax benefit homeowners enjoy from inflation by being able to deduct fully their mortgage interest payments, which include an inflation premium.

Including gains from the sale of a home in taxable income would also be inequitable if losses from home sales were not deductible. H.R. 9, a bill introduced in 1995 based on a proposal in the Contract with America, would allow the deductibility of losses on the sale of a home.

Any reduction in the tax benefit from home ownership would lower the value of existing housing relative to other assets such as corporate equity. Middle-income taxpayers would feel the loss in value most because homes are their principal asset.

As a way of reducing the tax benefit to home ownership, the primary alternative to taxing gains on sale is to limit the mortgage interest deduction (see REV-04). Limiting the mortgage interest deduction has the advantages of not hindering mobility or complicating recordkeeping. Taxing gains on sale, however, has the advantage of preserving the greatest tax break for first-time homebuyers.

REV-22 TAX CAPITAL GAINS HELD UNTIL DEATH

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Include Gains in the Last Income Tax Return of the Deceased[a]	b	8.7	9.1	9.6	10.1	37.5
Enact a Supplemental 10 Percent Estate Tax	b	0.8	0.9	1.0	1.1	3.8
Enact a Carryover Basis	b	0.9	1.8	2.9	4.0	9.6

SOURCE: Joint Committee on Taxation.

a. Estimate is net of reduced estate tax revenues.

b. Less than $50 million.

A capital gain or loss is the difference between the current value of an asset and the owner's basis. The owner's basis is the initial cost of the asset plus the cost of any subsequent improvements and minus any deductions for depreciation. When an asset is sold, the tax law normally requires that the owner include any realized gain in taxable income. The owner can deduct any realized loss against realized gains, and when the owner does not have gains in excess of losses, he or she can deduct up to $3,000 of the loss against other income.

An exception occurs when an owner holds an asset until death. In that case, the tax law allows the beneficiary to "step up" the basis to the asset's value as of the date of the decedent's death. When the beneficiary subsequently sells the asset, he or she pays tax on the gain that accrued after the decedent's death. The gain that accrued before the decedent's death is permanently excluded from taxable income. The estate of the decedent may pay taxes under the separate estate tax, but that tax applies equally to assets on which the decedent previously paid income tax and to assets with accrued capital gains that had escaped income taxation.

There are three ways to tax gains held at death: the law could require that gains held at death be included as income on the final income tax return of the decedent, the estate of the decedent could be subject to a supplemental tax rate on accrued gains, or the law could require that beneficiaries assume the decedent's basis in the asset they inherit. Under the last method of carryover basis, the beneficiaries would include the decedent's unrealized gain in their taxable income when they sell the asset.

Tax Gains on Final Return of the Decedent. Taxing accrued but unrealized gains on the final income tax return of the decedent would raise $37.5 billion from 1996 through 2000. This option would exclude gains on assets that a spouse inherits. Instead, the spouse would assume the basis of the decedent and pay tax on the full gain only if the spouse sold the asset. Any gains on assets that the decedent leaves to charity would also be exempt. The option would include gains on other assets in taxable income. It would also allow three additional modifications. First, to ease the problem of documenting the basis, the option would allow the estate to use an alternative basis equal to one-half of the asset's current value in computing the gain to be included on the final tax return. Second, the estate could claim the existing $125,000 exclusion on the gain from the sale of a principal residence if the decedent had not already claimed it. Third, the estate could exclude an additional $75,000 of any remaining gains. With all of those provisions, about one-tenth of the people who

hold accrued gains when they die would pay taxes on those gains. Finally, taxes paid on gains realized at death would be deductible under the estate tax.

Tax Gains Under the Estate Tax. An additional estate tax on accrued gains of 10 percent would raise $3.8 billion from 1996 through 2000. This option would apply a flat 10 percent rate to the same tax base as in the previous option. In addition, however, taxpayers could offset the additional tax with any unused credits under the estate tax. Because of those credits, few people would owe additional tax under this option. Only about 1 percent of estates currently pay the estate tax and the fraction paying the additional tax on gains would be about the same.

Tax Gains Upon Realization by Heirs (Carryover Basis). A third option would carry over the decedent's basis in assets left to the heirs and tax the gains of the decedent when the heirs sell their assets. This option would raise $9.6 billion from 1996 through 2000. The option would also allow heirs to set the basis of inherited assets at one-half of their current value. In addition, if the estate of the decedent paid any estate tax, shares of that tax would be added to the basis of all the estate's assets in proportion to their shares of the estate's value. Carryover basis would make most gains held at death taxable, but the timing of the tax payments would depend on when the heirs sold the inherited assets.

Gains held until death have always been exempt from income tax. The Congress enacted a carryover basis in the Tax Reform Act of 1976 but postponed it in 1978 and repealed it in 1980. Hence, it never took effect.

Taxing accrued gains at death, on either the last income tax return or the estate tax, would reduce the incentive for investors to hold assets until death in order to avoid tax. Current law encourages taxpayers to hold on to assets longer than they otherwise would. That "lock-in" effect distorts their investment portfolios and may hinder the flow of capital to activities with higher rates of return. Reducing the lock-in effect is one of the advantages of reducing the income tax on realized capital gains. Taxing gains at death would also reduce the lock-in effect, but, unlike a lower capital gains tax rate, it would reduce the preferential treatment of capital gains over ordinary income.

Using a carryover basis would not achieve the same unambiguous reduction of the lock-in effect that the other two options would achieve. Using a carryover basis lessens the incentive for the original owner to hold on to an asset until death. But an heir receiving an asset with a carryover basis has a stronger incentive to hold on to the asset than under current law.

A disadvantage of taxing gains at death is that the tax might force the family of the decedent to sell assets to pay the tax, although two of the three options minimize this problem. Forced sales of illiquid assets at an inopportune time can reduce their value substantially. Forcing heirs to sell a family farm or business would impose a particular hardship on families wanting to continue the enterprise. Forced sales would not occur if a carryover basis was used because heirs could defer the tax on unrealized gains until they sold the assets. In addition, taxing gains held at death through the estate tax would also reduce forced sales because the estate tax permits heirs who continue to operate a family farm or business to defer payment for five years and then spread payment over the next 10 years. Estates would receive no deferral, however, if gains were taxed on the final income tax return of the deceased. If this option was instead structured to allow the estate to value a family farm or business on its current use instead of by its market value, as is currently allowed under the estate tax, then the option would allow a deferral and would raise less revenue than cited.

Taxpayers and the Internal Revenue Service often have difficulty determining the basis of assets of closely held businesses, personal property, and assets for which the taxpayer did not keep adequate records. The difficulty in determining the amount of the basis was one of the main arguments that influenced the Congress to delay implementing carryover basis in 1978 and then to repeal it in 1980. Because people currently planning to hold assets until death might not have kept adequate records, documenting the basis would be particularly difficult immediately after passage of a law to tax gains held until death. Once a tax on gains held at death had taken effect, however,

people would have a reason to keep better records. In the interim, allowing estates and heirs to set the basis at one-half of the market value at the time of death would ease compliance. Finally, if gains held at death were taxable under the estate tax instead of the income tax, most taxpayers would be exempt because of the high estate tax credit (see REV-23).

REV-23 INCREASE ESTATE AND GIFT TAXES

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Reduce the Unified Credit	a	3.5	4.1	4.8	5.5	17.9
Convert the Credit for State Death Taxes into a Deduction	a	1.9	2.0	2.2	2.3	8.4
Include Life Insurance Proceeds in the Base	a	0.3	0.3	0.3	0.3	1.2

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

Current law imposes a gift tax on transfers of wealth during a taxpayer's lifetime and an estate tax on transfers at death. The estate and gift taxes together constitute a unified tax: one progressive tax is imposed on cumulative transfers during life and at death. Generous credits built into the system, however, exempt most estates from taxation; about 27,000 estates paid tax in 1993.

The estate and gift tax rates in 1996 will range from 18 percent on the first $10,000 of transfers to 55 percent on transfers of more than $3 million, but a unified credit of $192,800 effectively exempts the first $600,000 from taxation. As a result of the credit, taxable estates face an initial tax rate of 37 percent on the first $150,000 of transfers in excess of $600,000. An additional 5 percent surcharge applies to estates between $10 million and $21.04 million. The 5 percent surcharge phases out the benefit of graduated rates for those larger estates. In addition, current law phases out the unified credit for estates above $10 million. Another credit allows taxpayers to subtract a portion of state death taxes from federal estate tax liability.

In the Omnibus Budget Reconciliation Act of 1993, the Congress made permanent the top two estate tax rates that had been scheduled to decline to 50 percent after 1992. Those are the 53 percent rate that applies to estates of between $2.5 million and $3 million and the 55 percent rate that applies to estates of more than $3 million. The Congress could raise the estate and gift tax, without raising rates, by reducing allowable credits or by including proceeds of life insurance policies in the tax base.

Reduce the Unified Credit. Lowering the unified credit from $192,800 to $87,800 would raise $17.9 billion from 1996 through 2000 and make an additional 80,000 estates subject to tax. That lower credit is equivalent to an exemption of only the first $300,000 of transfers, instead of the current $600,000.

The estate and gift tax reduces the extent to which concentrations of wealth can be perpetuated, which may provide more equal opportunity for members of each new generation. The tax may also slow economic growth, however, by discouraging the accumulation of large estates.

The estate and gift tax provides the only tax on the unrealized capital gains held until death by people with the highest-valued estates. The estate and gift tax, however, taxes those unrealized gains at the same rate as other accumulated wealth that has already been taxed as income when earned (see REV-22).

Reducing the unified credit would extend the tax to more estates with small businesses, family farms, and large homes. The necessity of paying the tax would put pressure on heirs to sell those assets when they might prefer to retain them in the family or when the value of the assets was temporarily depressed. The estate tax has provisions for spreading payment over 15 years for small businesses and family farms, but even this burden could be prohibitive for retaining some family assets. Reducing forced liquidation of assets was one concern of the Congress when it voted in 1981 to raise the credit from $47,000 to $192,800. Furthermore, H.R. 9, a bill introduced in 1995 based on a proposal in the Contract with America, would raise the unified credit to $248,300 by 1998 and index it to inflation thereafter. Such a change would be equivalent to an exemption of the first $750,000 of transfers, instead of the current $600,000.

Convert the Credit for State Death Taxes into a Deduction. Currently, state death taxes reduce federal tax liability by a credit that ranges from 0.8 percent on transfers of $40,000 to 16 percent on transfers of more than $10 million. When implemented in 1926, the credit sometimes virtually eliminated federal tax liability because the top marginal rate on estate and gifts taxes was 20 percent. The credit acts as a state revenue-sharing system for estates taxed up to the 16 percent exclusion level. Consequently, a majority of states have adopted death tax systems that simply redistribute estate tax revenues from the federal to state governments. That shift is accomplished by imposing state taxes that exactly match the amount of the federal credit. Changing the state death tax credit to a deduction would raise $8.4 billion from 1996 through 2000 and would correspond to the itemized deduction that taxpayers receive for state and local income and property taxes.

An alternative change that yields about the same revenue is to reduce the amount of state tax credited by half so that the maximum credit is 50 percent of the amount paid to states. The two alternatives are not equivalent for estates of different sizes: the value of the deduction increases as the marginal tax rate rises, whereas the value of the credit is not affected by the marginal tax rate.

Include Life Insurance Proceeds in the Base of the Estate and Gift Tax. Life insurance is an alternative way of transferring wealth to descendants, but is currently exempt from the estate tax if the policyholder is someone other than the person who died. Making life insurance proceeds subject to estate and gift tax would raise $1.2 billion from 1996 through 2000.

REV-24 AMORTIZE A PORTION OF ADVERTISING COSTS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	3.5	6.2	4.7	3.1	1.8	19.3

SOURCE: Joint Committee on Taxation.

The income tax law allows taxpayers to deduct the ordinary costs of doing business. When a taxpayer purchases a durable asset for use in business, however, the expense may not normally be deducted immediately. Taxpayers must spread out (amortize) deductions over a number of years as the asset depreciates in value. That requirement is intended to match the timing of the deductions for depreciation with the timing of income earned from using the asset in business.

The rate at which such deductions are allowed, the "depreciation schedule," is normally faster than the rate at which an asset actually depreciates. For example, when a machine is expected to last 10 years, the depreciation schedule might allow the original cost to be deducted over five years. The sooner the deductions, the lower the effective rate at which income earned from using the asset is taxed. In the extreme, if the initial cost of a durable asset is deducted immediately, the net income from the asset would effectively not be taxed at all.

Currently, businesses may deduct advertising expenses in the year they are incurred. The benefits of advertising, however, may extend beyond the current year because advertising can create brand recognition or otherwise increase the demand for a business's products or services in later years. If advertising creates a durable asset, the immediate deduction allowed by current law provides it with a preference relative to investment in other durable assets.

Under this option, businesses could deduct 80 percent of all advertising expenses immediately, but would have to amortize the remaining 20 percent equally (using a "straight line" method) over four years. The option is intended to improve the match between the deductions and the income created from advertising. This option would raise about $19 billion from 1996 through 2000. After peaking at $6.2 billion in 1997, the estimated revenue gain would diminish to $1.8 billion by 2000 because the option represents an acceleration of tax revenue that would otherwise be paid in later years.

Because advertising can be difficult to define, this option would require complex rules to distinguish advertising costs from other ordinary business costs. Some marketing costs, such as those of notifying customers about price changes, redesigning a product package, or changing store displays, might or might not fit within the definition of advertising. If advertising was defined too narrowly, the depreciation requirement would be easy to avoid and difficult to administer. If advertising was defined too broadly, however, it would place an unintended burden on some forms of marketing.

The option would increase the after-tax cost of advertising and discourage its use. However, advertising also fulfills important economic functions by supplying information about products to prospective buyers. Advertising often provides information about prices, making it easier for buyers to find the lowest price, which can make markets more competitive. Advertising can also provide valuable information about the quality and other characteristics of products, making it easier for buyers to make good purchasing decisions.

Available research provides conflicting evidence about the durability of advertising. The actual rate at which advertising depreciates is unknown and prob-

ably differs for different types of advertising. The correct depreciation schedules would therefore be very difficult to construct, making the schedule chosen under this option somewhat arbitrary. If the depreciation period was too long under the option, advertising would be overtaxed relative to other economic activities, which would discourage economically important forms of advertising.

REV-25 ELIMINATE PRIVATE-PURPOSE, TAX-EXEMPT BONDS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Eliminate All Private-Purpose, Tax-Exempt Bonds	0.2	0.8	1.4	1.9	2.4	6.7
Raise the Cap and Extend Limits on Volume to New Issues of All Private-Purpose Bonds	0.1	0.3	0.5	0.7	0.9	2.5

SOURCE: Joint Committee on Taxation.

The tax law permits state and local governments to issue bonds that are exempt from federal taxation. For the most part, the bonds' proceeds have financed public investments such as schools, highways, and water and sewer systems. Beginning in the 1960s, however, state and local governments began to issue a growing dollar volume of tax-exempt bonds to finance quasi-public facilities, such as ports and airports, and private-sector projects, such as housing and shopping centers. Those bonds eventually became known as "private-purpose" bonds because the ultimate users of the tax-exempt-financed facilities were private, nongovernmental entities.

Private-purpose, tax-exempt bonds include mortgage bonds for rental housing and single-family (in some cases two-family) homes; bonds for exempt facilities, such as airports, docks, wharves, mass transit, and solid waste disposal; small-issue bonds for manufacturing facilities and agricultural land and property for first-time farmers; student loan bonds, which state authorities issue to increase the funds available for guaranteed student loans; and bonds for nonprofit institutions, such as hospitals and universities.

Although private-purpose bonds provide subsidies for activities that may merit federal support, tax-exempt financing is not the most efficient way to provide assistance. With a direct subsidy, the benefit would go entirely to the borrower; with tax-exempt financing, the borrower of funds shares the benefit with the investor in tax-exempt bonds. In addition, because tax-exempt financing is not a budget outlay, the Congress may not routinely review it as part of the annual budget process.

The Congress has placed restrictions on tax-exempt financing several times, beginning in 1968. During the 1980s, those restrictions included limiting the volume of new issues of tax-exempt bonds for some activities and eliminating or setting expiration dates on the use of tax-exempt bonds for other facilities. The Congress, however, frequently postponed some of the expiration dates. In the Omnibus Budget Reconciliation Act of 1993, the Congress permanently extended the use of mortgage bonds for single-family (and some two-family) homes and the use of small issues for manufacturing facilities and agricultural land and property for first-time farmers.

The Tax Reform Act of 1986 included interest earned on newly issued private-purpose bonds in the base for the alternative minimum tax and placed a single state-by-state limit on the volume of new issues of exempt facility bonds, small issues, student loan bonds, and housing and redevelopment bonds. The state volume limits are the greater of $50 per resident or $150 million a year. Bonds for publicly owned airports, ports, and solid waste disposal facilities and bonds for nonprofit 501(c)(3) organizations (primarily hospitals and educational institutions) are

exempt from the limits on issues of new bonds. Large private universities and certain other nonprofit institutions may not issue tax-exempt bonds if they already have more than $150 million in tax-exempt debt outstanding.

If the Congress eliminated tax exemption for all new issues of private-purpose bonds, the revenue gain would be about $6.7 billion in 1996 through 2000. That amount assumes that at least some construction of airports and sewage and solid waste facilities would qualify for tax-exempt financing as governmental in nature. Eliminating the tax exemption would eventually raise the cost of the services provided by nonprofit hospitals and other facilities that currently qualify for tax-exempt financing, but the cost increase would be small and gradual.

Including all bonds for private nonprofit and quasi-public facilities in a single state volume limit--while raising the limits beginning in 1996 to, say, $75 per capita or $200 million a year--would increase revenues by $2.5 billion in 1996 through 2000. Those changes would curb the growth of all private-purpose bonds without sharply reducing their use. The curb would primarily affect bond issues for nonprofit hospitals, which are not included in the current cap. The proposal would also apply to bonds for airport facilities, such as departure gates, which are for the exclusive private use of airlines under long-term leases, but would continue to allow unlimited tax-exempt financing of public airport facilities, such as runways and control towers.

REV-26 REDUCE TAX CREDITS FOR REHABILITATING OLDER BUILDINGS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Repeal Credit for Nonhistoric Structures and Reduce Credit for Historic Structures to 15 Percent	a	a	0.1	0.1	0.1	0.4
Repeal Both Credits	0.1	0.1	0.2	0.2	0.2	0.8

SOURCE: Joint Committee on Taxation.

a. Less than $50 million.

The Congress enacted tax credits for rehabilitation to promote the preservation of historic buildings, encourage businesses to renovate their existing premises rather than relocate, and encourage investors to refurbish older buildings. The credit rate is 10 percent for expenditures on commercial buildings built before 1936, and 20 percent for commercial and residential buildings that the Department of the Interior has certified as historic structures because of their architectural significance.

The credits favor commercial use over most rental housing and may therefore divert capital from more productive uses. Moreover, in favoring renovation over new construction, the credits may encourage more costly ways of obtaining additional housing and commercial buildings.

Rehabilitation may have social benefits to the extent that it discourages the destruction of historically noteworthy buildings. The government could promote that objective at a lower cost, however, by permitting a credit only for the renovation of certified historic buildings and lowering the credit rate. Some surveys have indicated that a 15 percent credit would be sufficient to cover the extra costs of both obtaining certification and undertaking rehabilitation of historic quality. Reducing the credit for historic structures to 15 percent and repealing the credit for nonhistoric structures would increase revenues over the 1996-2000 period by about $0.4 billion. Repealing both credits would raise about $0.8 billion over the same period.

REV-27 DISALLOW INTEREST DEDUCTIONS FOR CORPORATE-OWNED LIFE INSURANCE LOANS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	0.4	0.5	0.6	0.6	0.7	2.8

SOURCE: Joint Committee on Taxation.

Corporations purchase life insurance policies in part as protection against the financial loss from the death of their more important employees. Those purchases provide a tax benefit when corporations take out a loan with the cash value of the policy as collateral and deduct the interest expense from taxable income. This option would disallow the deduction for interest that corporations pay on loans secured by the cash value of life insurance policies. It would raise about $2.8 billion over the 1996-2000 period.

The tax code makes the tax benefit available by allowing the investment income ("inside buildup") within a life insurance policy to be generally exempt from the corporate income tax, while allowing a corporation to deduct a significant share of the associated loan's interest expense from taxable income. Such asymmetric treatment provides a tax arbitrage opportunity in that corporations can generate interest deductions that they can use to shelter other taxable income. Individuals cannot use that tax benefit because the tax code does not allow them to deduct those interest payments. Corporations that pay the alternative minimum tax receive only a limited opportunity for tax arbitrage because merely a part of their inside buildup is exempt from income tax. Those corporations, therefore, tend not to purchase such insurance policies for tax purposes.

The Congress enacted restrictions on this tax benefit in the Tax Reform Act of 1986, but the restrictions have not been particularly effective. In that act, the Congress restricted the size of a loan that qualifies for the interest deduction to $50,000 per insured employee. Since that time, corporations have spread smaller policies over a larger group of employees.

This tax option would broaden the restrictions enacted in 1986 by denying the deduction by corporations for interest from all life insurance policy loans, regardless of loan size. The Bush Administration proposed this option in its budget for fiscal year 1993, and the Reagan Administration proposed it in 1984. If the Congress was to tax all investment income from cash-value life insurance as it accrued (the option depicted in REV-16), then restricting the interest deductibility of policy loans would be unnecessary.

REV-28 REPEAL THE LOW-INCOME HOUSING CREDIT

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	0.5	1.3	1.7	2.0	2.4	7.9

SOURCE: Joint Committee on Taxation.

The low-income housing credit (LIHC) subsidizes the construction and substantial rehabilitation of low-income rental housing. Individuals and corporations who qualify for the LIHC receive tax credits over a 10-year period that are worth up to 70 percent, measured in present value, of the construction or rehabilitation costs of qualifying projects. The percentage is limited to 30 percent for projects that receive other federal subsidies. To qualify for the LIHC, project owners must set aside at least 20 percent of rental units for families whose income is below 50 percent of area median income, or 40 percent of units for families whose income is below 60 percent of median income. Rents are restricted. The set-aside and rent restrictions apply for at least 15 years. State housing agencies allocate the credits subject to statutory limits.

The low-income housing credit will reduce federal revenue by $2.2 billion in 1995 and is estimated to grow to $3.7 billion by 1999. Repealing the tax credit would raise $7.9 billion from 1996 through 2000.

Housing assistance could be provided to the same number of people at lower cost if the assistance was provided in the form of an expanded housing voucher program. Low-income tenants can use housing vouchers to pay for all or part of the rent for the housing of their choice, as long as it meets minimum standards for habitability. By contrast, the low-income housing credit subsidizes only new and substantially rehabilitated housing, which is the most expensive kind of housing.

High overhead costs also make some housing subsidized by the LIHC even more expensive to produce and rent. Private investors in low-income housing syndicates require high rates of return to compensate for the inherent risk of such investments, as well as the specific risks imposed by the credit itself. For example, projects that fail to comply with the requirements of the program may be subject to heavy penalties. Also, some investors cannot use the credits every year because of the limits on passive losses and on the use of business tax credits. Moreover, the administrative and marketing costs in organizing low-income housing syndicates are high, averaging 20 percent of project costs in some cases.

Advocates of the LIHC argue that it, in combination with subsidies such as rental assistance under section 8 of the United States Housing Act of 1937, assists many poor families and can be an important part of neighborhood revitalization efforts. In addition, affordable housing that meets minimal housing standards is in short supply in some areas with low-income families. For those reasons, a supply subsidy such as the LIHC might be a more effective policy tool than a demand subsidy such as housing vouchers. In addition, advocates argue that lower-middle-income people who benefit from the credit are neglected by traditional housing programs, which primarily assist poor families.

Although providing support for low-income housing through housing vouchers instead of the LIHC could potentially provide assistance to the same number of families at lower cost, budget constraints on discretionary spending might make it difficult to repeal the credit in favor of an expanded voucher program funded by annual appropriations. The discretionary spending limits of the Balanced Budget and Emergency Deficit Control Act of 1985

(as amended in 1990 and 1993) already impose severe constraints on funding for existing discretionary programs. Expanding the housing voucher program would subject those programs to even greater budgetary pressures.

REV-29 TAX CREDIT UNIONS LIKE OTHER THRIFT INSTITUTIONS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Tax All Credit Unions	0.8	0.8	0.9	0.9	0.9	4.3
Tax Credit Unions with More Than $10 Million in Assets	0.8	0.8	0.8	0.8	0.8	4.0

SOURCE: Joint Committee on Taxation.

Credit unions are nonprofit institutions that provide their members with financial services such as accepting deposits and making loans. The federal income tax treats credit unions more favorably than competing thrift institutions, such as savings and loan institutions and mutual savings banks, by exempting their retained earnings from tax. As a result, more credit unions and fewer taxable thrifts exist than would otherwise be the case. That situation reduces economic efficiency in that competing institutions might otherwise provide the same services at lower cost.

Credit unions, savings and loans, and mutual savings banks were originally all tax-exempt, but in 1951 the Congress removed the tax exemptions for savings and loans and mutual savings banks. It considered them to be more like profit-seeking corporations than nonprofit mutual organizations.

Since 1951, credit unions have come to resemble those other thrift institutions in certain respects. Credit unions no longer limit membership to people sharing a common bond, which was usually employment. Since 1982, the regulators have allowed credit unions to extend their services to others, including members of other organizations. In addition, most credit unions allow members and their families to participate permanently, even after members have left the sponsoring organization. Credit union membership has grown from about 5 million in 1950 to about 65 million today. That leap in numbers offers evidence that credit unions, like taxable thrifts, now serve the general public. In addition, credit unions retain earnings like thrift institutions. Credit unions argue that they retain earnings as protection against unexpected events, but other thrift institutions argue that credit unions use the retained earnings to finance expansion. Moreover, credit unions are becoming more like savings and loans and mutual savings banks in the services they offer. A significant number of credit unions currently offer such services as first and second mortgages, direct deposit, automatic teller access, preauthorized payments, credit cards, safe deposit boxes, and discount brokerage services.

Many smaller credit unions, however, retain the characteristics of nonprofit mutual organizations and perhaps should not be subject to taxation. For instance, only volunteers from the membership manage and staff some of those credit unions. Moreover, many of those smaller credit unions do not expand their membership beyond their immediate common bond or provide services comparable to competing thrift institutions. To protect those smaller credit unions, the Congress could choose to exempt from taxation those credit unions with assets below $10 million. Such an action would exempt about 61 percent of all credit unions from taxation, although they hold only about 9 percent of all credit union industry assets.

Taxing all credit unions like other thrift institutions would raise $4.3 billion in 1996 through 2000. Taxing only credit unions with assets above $10 million would raise about $0.3 billion less.

REV-30 REPEAL TAX PREFERENCES FOR EXTRACTIVE INDUSTRIES

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Repeal Expensing of Intangible Drilling, Exploration, and Development Costs	0.8	1.4	1.3	1.2	1.1	5.8
Repeal Percentage Depletion	0.9	0.9	1.0	1.0	1.0	4.8

SOURCE: Joint Committee on Taxation.

Under the normal tax rules for cost recovery, taxpayers cannot immediately deduct purchases of capital assets such as plant and equipment from taxable income. Instead, they must capitalize the purchase price and then deduct the cost at a prescribed rate over the asset's useful life either by depreciation or depletion. Those rules also apply to assets that the user constructs instead of purchasing (self-constructed assets). Although oil and gas wells and mineral mines are self-constructed assets, they benefit from special cost-recovery rules. Taxpayers may immediately deduct ("expense") certain exploration and development costs, including intangible drilling costs, that under normal tax rules they would have to capitalize and deduct more slowly.

Expensible exploration and development costs include costs for excavating mines and drilling wells. They also include prospecting costs for hard minerals, but not for oil and gas. Current law limits expensing to 70 percent of those costs for corporations engaged in extracting hard minerals and for integrated producers of oil and gas that also operate sizable refineries. Those corporations may deduct the remaining 30 percent of costs over a 60-month period.

The percentage depletion method of cost recovery allows taxpayers to deduct a certain percentage of a property's gross income, regardless of the actual capitalized costs. Current law typically allows nonintegrated oil and gas companies to deduct 15 percent of the gross income from oil and gas production up to 1,000 barrels per day. The deduction for oil produced from marginal properties can be up to 25 percent, however, if the market price of oil drops low enough. (In contrast, integrated oil and gas producers must use the normal method of cost depletion to recover capitalized costs.) Producers of hard minerals may also use percentage depletion, but the statutory rates vary. Minerals eligible for percentage depletion include sand (5 percent), coal (10 percent), iron ore (14 percent), dimension stone and mollusk shells (14 percent), oil shale (15 percent), gold (15 percent), and uranium (22 percent). The tax law limits the amount of percentage depletion to 100 percent of the net income from an oil and gas property and 50 percent of the net income from a property with hard minerals.

Because percentage depletion depends on the value of production rather than the amount of capitalized costs, it is more akin to a production subsidy than a method of cost recovery. The subsidy provides little or no incentive to develop or expand production from marginal properties, however, because the amount of percentage depletion cannot exceed net income. Because marginal properties that are more costly to develop produce less net income, their deductions for percentage depletion per dollar of gross income are smaller.

Percentage depletion and the expensing of exploration and development costs encourage oil and

gas production and extraction of hard minerals, but the incentives are not available to all producers on an equal basis. Integrated oil and gas producers may not claim percentage depletion deductions that independent producers can use. Furthermore, most corporations can deduct immediately only 70 percent of their exploration and development costs, including intangible drilling costs, whereas noncorporate producers can expense all of them. Finally, because percentage depletion and expensed exploration and development costs are tax preferences under the alternative minimum tax, producers who pay the minimum tax must defer or even forgo those deductions, but producers who pay the regular income tax may take them in the current year.

There are several reasons to repeal expensing and percentage depletion. First, those provisions allocate capital to drilling and mining that firms could use more productively elsewhere in the economy. Second, they encourage the use of scarce domestic oil and gas resources, which may lead to a greater reliance on foreign energy producers in the future. Third, the provisions fail to provide all producers with the same incentive, which lessens their effectiveness in encouraging production.

Repealing the expensing of intangible drilling costs and other exploration and development costs would raise nearly $6 billion in 1996 through 2000, assuming that firms could still expense the costs of dry holes, unproductive mines, and worthless mineral rights. Repealing percentage depletion would raise nearly $5 billion over the same five-year period.

REV-31 CAPITALIZE THE COSTS OF PRODUCING TIMBER

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	0.3	0.5	0.5	0.5	0.4	2.2

SOURCE: Joint Committee on Taxation.

Businesses that incur costs to produce or purchase products that will be sold in future years generally cannot deduct those costs until the products are sold. Instead of deducting production and acquisition costs in the year they are incurred, businesses must capitalize such costs by adding them to the cost basis of inventory. When the product is sold from inventory, the business deducts the cost basis of the inventory from the sales price to determine the amount of taxable income. When businesses do not capitalize costs properly, business income is not measured correctly because the costs associated with producing goods and services are not matched with the sale of the goods and services.

The Tax Reform Act of 1986 (TRA-86) established a uniform set of rules for capitalizing production costs, but explicitly exempted the production of timber and certain ornamental trees. The rules require businesses to capitalize not only direct costs, such as the cost of production materials and the compensation paid to production workers, but also the allocable portion of most indirect costs that benefit production. Those indirect costs include property taxes and insurance costs for the plant and equipment, and the salaries and benefits of production managers. Moreover, if a product takes longer than two years to produce or if it has a useful life of 20 years or more, the interest cost that is allocable to the production of the product must also be capitalized.

Because the production of timber and certain ornamental trees is currently exempt from the uniform capitalization rules, the producers of those products can deduct costs that otherwise would have to be capitalized. The deductible costs include the costs of labor and materials to remove unwanted trees and to control fire, disease, and insects; interest and insurance costs; property taxes; and administrative overhead. By allowing timber producers to deduct such production costs before the timber is harvested or sold, the tax code in effect subsidizes timber producers by deferring tax that they otherwise would owe on their income. (Under certain circumstances, however, the deferral granted to noncorporate producers of timber may be greatly curtailed by the limit of the tax code on losses from passive business activities.)

The subsidy from tax deferral distorts investment behavior in two ways: more private land is devoted to timber production, and trees are allowed to grow longer before they are cut. Unless timber production offers important spillover benefits to society, those distortions lower the social return on investment in timber below that of alternative investments.

Whether or not timber production offers important spillover benefits is unclear. Although standing timber provides some spillover benefits by deterring soil erosion and absorbing carbon dioxide (a gas linked to global warming), the cutting of timber can lead to soil erosion. In addition, the production of wood and paper products and the disposal of them add to pollution.

Capitalizing costs incurred after December 31, 1995, to produce timber and ornamental trees (in accord with the uniform capitalization rules of TRA-86) would raise $2.2 billion in revenue from 1996 through 2000 by accelerating tax payments from timber producers. In the long run, the capitalization of timber production costs would raise the price of domestic timber and lower the value of land used to grow timber. Moreover, lease payments to private

landowners by timber growers would be likely to decline, causing some land that historically has been devoted to growing timber to be used in other ways. In the short run, however, capitalizing timber production costs might lower the price of domestic timber because producers would have an incentive to harvest timber earlier when currently deductible costs have to be capitalized.

REV-32 REPEAL THE PARTIAL EXEMPTION FOR ALCOHOL FUELS FROM EXCISE TAXES ON MOTOR FUELS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	0.4	0.6	0.5	0.5	0.5	2.5

SOURCE: Joint Committee on Taxation.

The tax code imposes excise taxes on motor fuels, but it partially exempts fuels that are certain blends of gasoline and alcohol. Immediate repeal of the partial excise tax exemption would raise $2.5 billion in revenues over the 1996-2000 period. That estimate assumes that the Congress also repeals the alcohol fuels credit, an alternative tax benefit that can be used instead of the partial excise tax exemption. The credit, however, is in almost all cases less valuable than the exemption and is rarely used.

The exemption rate depends on the percentage of alcohol in the fuel and whether the alcohol was made from a fossil fuel (nonrenewable) or nonfossil fuel (renewable) source. The exemption applies only to alcohol fuels produced from nonfossil fuel sources. For example, gasohol, which is 90 percent gasoline and 10 percent (renewable) ethanol--an alcohol fuel produced primarily from corn and sugar--receives a 5.4 cents per gallon exemption from the 18.4 cents per gallon tax on gasoline.

One purpose of the tax benefit--enacted in the late 1970s--was to increase national security by reducing the demand for imported oil and thereby reducing U.S. dependence on foreign oil sources. Another purpose was to provide an additional market for U.S. agricultural products by encouraging domestic production of ethanol. Over the last several years, U.S. environmental action has increased the value of ethanol by mandating the oxygen content of motor fuels in many areas of the country. Use of oxygenated fuels in motor vehicles generally produces less carbon monoxide pollution than does gasoline.

Before the Clean Air Act Amendments of 1990 were enacted, the tax benefits encouraged energy producers to substitute ethanol for gasoline--and successfully so. Motor fuels blended with ethanol made up less than 1 percent of the total motor fuels market in 1980, but that proportion grew to nearly 7 percent by 1990. Because ethanol production uses more resources than gasoline production, the resulting allocation of resources may create economic inefficiencies if the value of those resources in alternative uses is greater than the value of the diminution in air pollution.

The Clean Air Act Amendments of 1990 reduced the need for the partial excise tax exemption. In that legislation, the Congress mandated the minimum oxygen content of gasoline in areas of the country with unacceptable levels of air pollution.

In the areas where the mandate applies, the partial excise tax exemption for alcohol fuels affects the type of oxygenating agent used but not the total use of oxygenated fuels. The exemption only applies to oxygenated fuels made from renewable resources, effectively meaning ethanol. The other major source of oxygen in gasoline is methyl tertiary butyl ether (MTBE), which does not receive a tax benefit because it is made from natural gas. Given the mandate, ethanol primarily competes with MTBE, not gasoline, in those markets.

The tax benefit encourages the use of higher-cost ethanol rather than lower-cost MTBE. Some proponents of ethanol argue that it is better for the environ-

ment than MTBE. But that argument is not settled. Ethanol appears to reduce carbon monoxide emissions from automobiles more than MTBE does; but ethanol evaporates quickly, especially in hot weather, contributing to ozone pollution. In response, companies have developed ethyl tertiary butyl ether (ETBE), a product derived from ethanol that does not have the same evaporative problem. It also qualifies for the tax benefit. ETBE, however, does not contribute to reduced carbon monoxide emissions, as does ethanol.

The net effect that repealing the exemption would have on ethanol producers, farm income, and agricultural support payments depends on market conditions and what discretionary action the Secretary of Agriculture takes. Income of ethanol producers would probably fall.

The revenue effect cited for this option does not reflect the Environmental Protection Agency's ruling of June 1994 that would expand the market for ethanol. The agency ruled that renewable oxygenates must constitute 15 percent of the total amount of the mandated oxygen in reformulated gasoline, the type of fuel required year-round starting in 1995 in areas of the country with severe ozone pollution. (The percentage increases to 30 percent in 1996 and thereafter.) The rule, however, has not gone into effect pending resolution of a legal challenge. The revenue projection shown here does not reflect the increased use of ethanol that would result from that rule because the court challenge remains unresolved.

REV-33 IMPOSE A VALUE-ADDED TAX

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Impose a 5 Percent Rate, with a Comprehensive Base	0	116.0	179.4	188.7	198.3	682.4
Impose a 5 Percent Rate, with Food, Housing, and Medical Care Excluded	0	63.4	98.0	103.1	108.3	372.8

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are based on an effective date of January 1, 1997. They are net of reduced income and payroll tax revenues, but do not reflect added administrative costs.

A value-added tax (VAT) is a form of general tax used in more than 50 countries, including Canada, Japan, and all European countries except Iceland. It is typically administered by taxing the total value of sales of all businesses, but allowing businesses to claim a credit for taxes paid on their purchases of raw materials, intermediate materials, and capital goods from other businesses. As a result, only sales to consumers end up being taxed.

A 5 percent VAT on a broad consumption base (as defined in Table 5-3) would increase net revenues by about $116 billion in 1997 and by about $680 billion through 2000. Most VATs, however, do not tax such a broad base. The typical European VAT, for example, excludes food, housing, and medical care. It also partially excludes financial services because they are difficult to tax. A 5 percent VAT on a narrower base (as defined in Table 5-3) would net only about $63 billion in 1997 and nearly $375 billion through 2000. Those revenue estimates assume that collections would not begin until January 1, 1997, because the Internal Revenue Service would need more than a year to set up a VAT.

A VAT might be preferable to an income tax increase because it would not discourage saving and investment by taxing their return. In addition, a broad-based VAT with a single rate would distort economic decisions less than an equal revenue increase in selective consumption taxes. The VATs that have been enacted in other countries, however, include many tax preferences and multiple rates. Such a tax would distort consumption choices more than a single-rate, broad-based VAT and could be more distorting than higher income tax rates.

A VAT makes the price consumers pay higher than the price sellers receive. Therefore, adopting one would cause an initial jump in the overall consumer price level because the government computes the consumer price index on a tax-inclusive basis. The increase in the price level, however, would not necessarily lead to further inflation, depending on how the Federal Reserve System responded. Many experts believe that the Federal Reserve would adjust the money supply in a way that would maintain nominal income. Under that scenario, macroeconomic models generally predict little inflation beyond the initial price jump.

The VAT is a regressive tax in the sense that families with lower annual income pay a larger share of their income in tax. That effect occurs because the ratio of consumption to annual income is higher for low-income families than for high-income families. A VAT is less regressive over people's lifetimes than in a single year because income and consumption nearly match over a lifetime, even though income tends to fluctuate annually more than consumption

does. Many economists believe that lifetime measures of tax burdens are more meaningful than annual measures.

Table 5-3.
The Size of Two Possible Tax Bases for a Value-Added Tax, 1993

Items Included in Tax Base	Amount (Billions of dollars)
Broad Tax Base	
Total Personal Consumption in Gross Domestic Product	4,378
Net Purchases of Residental Structures	251
Subtotal	4,629
Exclusions from the Base[a]	
Rental value of housing	-629
Religious and welfare activities	-123
Subtotal	-752
Total	3,877
Narrower Tax Base	
Total Personal Consumption in Gross Domestic Product	4,378
Exclusions from the Base[a]	
Rental value of housing	-629
Religious and welfare activities	-123
All medical care (including insurance)	-760
Food consumed at home	-374
Food furnished to employees	-12
Food produced for farm consumption	b
Brokerage, banking, and life insurance services	-285
Local transit (excluding taxis)	-6
Clubs and fraternal organizations	-9
Tolls for roads and bridges	-2
Private education and research	-106
Subtotal	-2,306
Total	2,072

SOURCE: Congressional Budget Office based on national income and product accounts.

a. The excluded amount assumes that the specified consumption is taxed at a zero rate.

b. Reduction of less than $500 million.

A VAT could be made slightly less regressive by granting tax preferences for the goods and services low-income people generally consume. Those preferences, however, would substantially increase the costs of enforcement and compliance, and they would reduce revenues. Another way to lessen the VAT's regressivity would be to allow additional exemptions or refundable credits for low-income people under the federal income tax. But exemptions for low-income people would also reduce the revenue gain and would cause many people to file tax returns who otherwise would have no need to file.

Like any new tax, a VAT would impose additional administrative costs on the federal government and additional compliance costs on businesses. If the United States adopted a VAT that was similar to the ones used in Europe, those costs could be quite substantial. CBO estimates that administering such a VAT would cost the government more than $1 billion annually, and complying with it would cost businesses $6 billion to $10 billion annually. Those costs would be lower if the VAT exempted more small businesses from collecting the tax and if it taxed as many goods and services as possible at the same rate.

A retail sales tax is another way to tax consumption. Because a sales tax is collected entirely at the retail level, however, the incentive to evade a sales tax would be much greater than the incentive to evade a VAT. Moreover, because the sales tax lacks an effective credit mechanism for the taxes that businesses pay on their purchases, it taxes some business purchases by mistake. Given the drawbacks of a retail sales tax, most countries with general consumption taxes have chosen a VAT over the sales tax.

Other ways to tax a broad consumption base are possible, even though no country has ever tried one. A tax on consumed income, for example, would tax income but with an exclusion for net saving. Under a consumed-income tax, taxpayers could deduct all contributions to qualified saving accounts but would pay tax on net withdrawals. Because individuals would pay tax on a measure of their total consumption, the tax could include a graduated rate schedule, like the rate schedule of the individual income tax. That schedule would make the consumed-income tax less regressive than a VAT.

REV-34 IMPOSE A BROAD-BASED ENERGY TAX

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Impose a Tax on the Carbon Content of Fossil Fuels ($15.75 per ton)	13.7	20.4	21.3	22.4	23.5	101.3
Impose a Tax on the Heat Content of Fuels (34.5 cents per million Btus)	14.6	20.0	20.8	21.8	22.7	99.9
Impose an Ad Valorem Tax on Energy Consumption (5 percent of value)	14.5	20.0	20.8	21.7	22.6	99.6

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues. Increases in federal government expenditures for energy products under these options are not included.

Broad-based energy taxes fall into three types: a carbon tax, a Btu tax, and an ad valorem tax. A tax on the carbon content of fossil fuels (coal, oil, and natural gas) would help to reduce global warming by reducing carbon emissions. The tax, however, would be relatively harsh on coal-producing regions and regions that generate more electricity from coal than from other fuels. A tax on the heat content of fuels (measured in British thermal units, or Btus) that raised the same revenue would be more regionally neutral but would be less effective in reducing carbon emissions. An ad valorem tax on energy raising the same revenue would increase energy prices in a nondistortionary way, but would also be less effective in reducing carbon emissions than a carbon tax. None of these options would meaningfully reduce U.S. dependence on foreign oil.

Broad-based energy taxes also would have adverse distributional effects because families with lower annual income spend a larger share of their income on energy than families with higher income. The distributional effects of energy taxes are not generally significantly different, however, from those of a general consumption tax, such as a value-added tax (see REV-33), which would not further environmental goals.

All three options would cause a one-time increase in the U.S. general price level of about 0.4 percentage points and an offsetting one-time decline in the dollar's foreign exchange value. The prices of energy-intensive goods would increase more than the general price increase, and the prices of goods that are not energy intensive would increase less. As a result, the prices of goods produced in the United States that are energy intensive--such as aluminum and chemicals--would rise when valued in foreign currency terms, making those U.S. products less competitive in world markets. Similarly, the prices of goods produced in the United States that are not energy intensive would fall when valued in foreign currency terms, making them more competitive in world markets.

To alleviate the adverse effects on the domestic energy and energy-intensive industries, the United States could institute border adjustments on a limited or extensive basis. A limited border adjustment might levy the energy tax on imported energy and

rebate the tax on exported energy. All three options make that adjustment. The adjustment eases the impact on the domestic energy industry, but not the impact on domestic producers of energy-intensive goods. More extensive border adjustments on the energy content of all goods would also mitigate the adverse effects on energy-intensive industries. However, they would be complicated and costly to administer and might violate the General Agreement on Tariffs and Trade. Therefore, they are not included in these options.

Impose a Tax on the Carbon Content of Fossil Fuels. A tax of $15.75 per ton of carbon content (in 1996 dollars) of coal, oil, and natural gas, if it was indexed for inflation, would raise about $100 billion from 1996 through 2000. The relative carbon content of the three fossil fuels would dictate the specific tax rate for each fuel. That tax rate, based on average carbon content, is equivalent to a tax of approximately $9.50 per ton of coal, $2 per barrel of oil, and about $0.25 per thousand cubic feet of natural gas (in 1996 dollars).

Imposing a carbon-based tax at the minemouth, wellhead, or dockside for imports could discourage the use of fossil fuels and also encourage switching from higher carbon-emitting fuels to lower ones, thereby reducing subsequent emissions of carbon dioxide (CO_2). The Congress could impose higher tax rates on fossil fuels than assumed in this option. It could, for example, impose taxes either at levels that would discourage future increases in CO_2 emissions or at levels that would reduce emissions from current amounts by some target date.

Recent scientific evidence on the potential for global warming through an intensified greenhouse effect has prompted international concern about the emissions of greenhouse gases such as CO_2. The United States, along with some 150 nations, signed a climate treaty at the June 1992 "Earth Summit" conference in Brazil, agreeing to initiate steps aimed at controlling emissions of greenhouse gases. In 1993, the Administration announced an "Action Plan" for reducing greenhouse gases through voluntary action by government and businesses. A $15.75 per ton carbon tax would reduce CO_2 emissions by about 1 percent to 2 percent from projected levels by 2000.

U.S. action, however, would not significantly reduce global CO_2 concentrations in the atmosphere if other countries did not make similar efforts. In addition, since scientists do not fully understand how emissions of greenhouse gases affect atmospheric concentrations, even reducing CO_2 emissions significantly may not prevent global warming. Moreover, a tax that significantly reduced emissions could impose economic costs that exceeded the benefits of such a policy. Adjusting to lower energy use would be costly, especially in energy extracting and processing industries and in energy-intensive manufacturing sectors. Furthermore, other means of controlling greenhouse gases could be adopted. Another alternative to raising energy prices through an excise tax on carbon is to adapt to a warmer globe. That approach could be justified if the expected costs of adjusting to a warmer climate were less than the costs of adjusting to a tax or other methods of reducing greenhouse emissions.

Compared with the other broad-based energy tax options, the carbon tax would impose greater costs on colder regions of the country, like the Northeast and Midwest, and on regions that produce electricity primarily from coal. Coal-producing regions might also be hurt relatively more as utilities switched from coal to other energy sources to produce electricity.

Impose a Tax on the Energy Content of All Fuel Sources. A tax of 34.5 cents per million Btus (in 1996 dollars) imposed on all energy sources and indexed for inflation would also raise about $100 billion from 1996 through 2000. The relative heat content of coal, oil, and natural gas would dictate the specific tax rate for each fuel. That tax rate, based on average heat content, is equivalent to a tax of approximately $7.35 per ton of coal, $1.90 per barrel of oil, and about $0.35 per thousand cubic feet of natural gas (in 1996 dollars).

Under this option, the change in relative prices between fossil fuels is similar to the change in relative prices under the carbon tax option because the carbon content of fuel is closely related to the heat content of fossil fuels. On average, the tax rates in this option are lower than those under the carbon tax option because the tax base is broader, including nuclear, hydropower, and other renewable resources.

Nonetheless, the tax rate on natural gas is higher than under a carbon tax because the heat content is higher relative to the carbon content for natural gas than for coal and petroleum. Because the average price increases for fossil fuels would be smaller under a Btu tax than under a carbon tax, the reduction in CO_2 emissions would not be quite as large as under the carbon tax option.

The tax would be easiest to administer if the Internal Revenue Service (IRS) collected it at the points where fossil fuels enter the economy--minemouth, wellhead, or dockside for imports--because that would minimize the number of taxpayers. The tax would need to be imposed on fuel used in the fuel production and distribution industries to capture all the energy consumed. If the tax was not imposed on alternative fuels--including hydroelectricity, nuclear, ge othermal, and synthetic fuels--then the regional disparities of the tax would be magnified. For example, the Northwest generates more electricity from hydropower than other regions of the country.

The House of Representatives passed one version of a modified Btu tax in 1993. The Congress did not approve that option, however.

Impose an Ad Valorem Tax on All Energy. A tax of 5 percent levied at the retail level on all forms of energy would also raise about $100 billion over the 1996-2000 period. An ad valorem tax applied at the retail level would leave the relative prices of different energy sources unchanged and therefore would not encourage consumers to switch from one form of energy to another. As a result, it would not decrease CO_2 emissions as much as a carbon tax for the same revenue increase. In addition, enforcement would be relatively costly with such a tax because the IRS would collect it from a large number of retailers. If the IRS collected the tax at an earlier stage of the distribution process, tax enforcement would be less costly, but the tax would then affect relative energy prices because different fuels have different markups at the retail level.

REV-35 INCREASE EXCISE TAXES ON TOBACCO AND ALCOHOLIC BEVERAGES

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Increase Cigarette Tax to 48 Cents per Pack	3.5	4.0	3.9	3.9	3.8	19.1
Increase Cigarette Tax to 99 Cents per Pack	9.2	10.3	10.1	9.9	9.6	49.1
Increase All Alcoholic Beverage Taxes to $16 per Proof Gallon	3.7	4.5	4.5	4.5	4.6	21.8
Index Cigarette and Alcohol Tax Rates for Inflation	0.4	0.7	1.1	1.4	1.8	5.4

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues.

Federal alcohol and tobacco taxes raised $13.5 billion in 1994, including $7.6 billion from taxes on distilled spirits, beer, and wines, and $5.9 billion from taxes on tobacco. The Omnibus Budget Reconciliation Act of 1990 increased the federal excise tax on tobacco and most alcoholic beverages.

Smoking and drinking can create costs to society that the prices of tobacco and alcoholic beverages do not reflect. Examples of those "external costs" include higher health insurance costs to cover the medical expenses linked to smoking and drinking, the effects of cigarette smoke on the health of nonsmokers, and the loss of lives and property in alcohol-related accidents.

By raising the price of tobacco and alcoholic beverages, excise taxes can result in consumers' paying the full cost for smoking and drinking. To the extent that excise taxes lead to reduced consumption of tobacco and alcoholic beverages, tax increases can decrease the total external costs that smoking and drinking produce. If those external costs primarily come from heavy or abusive consumption, however, then higher taxes on tobacco and alcoholic beverages might unduly penalize moderate and infrequent smokers and drinkers. Furthermore, some research suggests that, at least for tobacco, current taxes may more than adequately compensate for the external costs that smokers impose on society.

Increasing excise taxes to reduce consumption may be desirable regardless of the effect on external costs if consumers are either unaware of or underestimate the harm that their smoking and drinking does to them. If most consumers of cigarettes overestimate rather than underestimate the risks involved with smoking, as some studies have shown, then additional taxes would not be warranted to correct for poor information about the health consequences of smoking. Teenagers, however, may not be prepared to evaluate the long-term effects of smoking and drinking. Evidence suggests that teenage smoking and drinking declines in response to higher prices for tobacco and alcoholic beverages. A number of national medical organizations have supported a substantial increase in the existing federal excise tax on tobacco in the interests of reducing teenage smoking.

Taxes on tobacco and alcoholic beverages are regressive when compared with annual family income; that is, taxes are a greater percentage of in-

come for low-income families than for middle- and upper-income families. (See Congressional Budget Office, *Federal Taxation of Tobacco, Alcoholic Beverages, and Motor Fuels*, August 1990.)

Increase the Cigarette Tax. The current federal excise tax on cigarettes is 24 cents per pack. Raising it to 48 cents a pack would increase net revenue by about $19 billion between 1996 and 2000. The President's Health Security Act proposed to raise the federal excise tax on cigarettes to 99 cents per pack. That change to the excise tax rate would increase net revenues by about $49 billion between 1996 and 2000.

Increase Taxes on Alcoholic Beverages. Current federal excise taxes on beer and wine remain much lower than the federal excise tax on distilled spirits in terms of the tax per ounce of ethyl alcohol. The current tax on distilled spirits of $13.50 per proof gallon results in a tax of about 21 cents per ounce of alcohol. The current tax on beer of $18 per barrel results in a tax of about 10 cents per ounce of alcohol (assuming an alcoholic content for beer of 4.5 percent), and the current tax on table wine of $1.07 per gallon results in a tax of about 8 cents per ounce of alcohol (assuming an average alcoholic content of 11 percent).

Increasing the federal excise tax to $16 per proof gallon for all alcoholic beverages would raise $21.8 billion between 1996 and 2000. A tax of $16 per proof gallon would result in a tax of about 25 cents per ounce of ethyl alcohol. It would raise the tax on a 750-milliliter bottle of distilled spirits from about $2.14 to $2.54, the tax on a six-pack of beer from about 33 cents to 81 cents, and the tax on a 750-milliliter bottle of table wine from about 21 cents to 70 cents.

Index Cigarette and Alcohol Tax Rates for Inflation. Indexing cigarette and alcoholic beverage tax rates annually for inflation during the preceding year would raise $5.4 billion between 1996 and 2000. Indexing those taxes would prevent inflation from eroding real tax rates and would avoid the need for abrupt increases in the future.

An alternative to indexing would be to convert current unit taxes on quantities of these goods to ad valorem taxes, which equal a percentage of the manufacturer's price. That method would link tax revenues to price increases, although it would tie revenues to the price of taxed goods, not the general price level. A shortcoming of the ad valorem tax is that it might create incentives for manufacturers to lower sales prices artificially to company-controlled wholesalers in order to avoid part of the tax.

REV-36 INCREASE TAXES ON PETROLEUM AND MOTOR FUELS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Impose Tax on Domestic and Imported Oil ($5 per barrel)	15.6	20.8	21.0	21.3	21.7	100.4
Impose Oil Import Fee ($5 per barrel)	7.0	9.7	10.2	10.6	11.2	48.7
Increase Motor Fuel Taxes by 12 Cents per Gallon	9.4	12.4	12.1	12.0	12.2	58.1
Increase Motor Fuel Taxes by 10 Cents per Gallon Each Year for Five Years	7.9	18.2	27.9	37.1	46.1	137.2

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues. Increases in federal government expenditures for energy products under these options are not estimated.

Increasing energy taxes could raise significant amounts of revenue, encourage conservation by making energy more expensive, reduce pollution, and decrease the country's dependence on foreign oil suppliers. The United States depends on foreign sources for about half of its oil and about one-fifth of its total energy. Recent experience illustrates that this dependence on foreign sources exposes the U.S. economy to potential interruptions in energy supplies and to volatile energy prices.

Imposing new or higher energy taxes would raise energy prices and reduce energy consumption, thus helping to promote conservation. To the extent that taxes on oil reduce the demand for imported oil, foreign suppliers would absorb part of the tax through lower world oil prices. To the extent that energy taxes reduce energy consumption, the taxes would also reduce carbon dioxide emissions and could, therefore, contribute to efforts to reduce global warming.

Energy taxes would have different effects on taxpayers in different parts of the country and with different incomes. Taxes that increase the relative price of fuel oil would have the greatest impact on consumers in the Northeast, and taxes that increase the relative price of gasoline would have the greatest impact on consumers in the West. In addition, taxes on gasoline and other energy products represent a greater percentage of income for low-income families than for middle- and upper-income families.

Taxing energy is not the only way of reducing dependence on foreign oil supplies. Stockpiling oil is arguably a better way of coping with the risks of increased dependence on imports because it would not artificially reduce current energy use by households and businesses. That argument is based on the premise that, aside from the problem of interruptions in supply, world energy prices accurately reflect real resource costs and thus already provide an appropriate incentive to conserve energy.

Impose an Excise Tax on Domestic and Imported Oil. An excise tax of $5 per barrel on all crude oil and refined petroleum products--both domestically produced and imported--would raise revenues by

about $100 billion from 1996 through 2000. It could increase the price of a gallon of gasoline or fuel oil by as much as 12 cents.

A tax on oil would increase the price that consumers must pay, giving them an incentive to use less oil either through conservation efforts or by switching to an alternative source of energy such as natural gas or coal. The tax would cause oil reserves to decline in value, and coal and gas reserves to increase in value. Those shifts in value would discourage exploring for and producing oil and would encourage producing coal and natural gas.

An oil tax, whether on all oil or only imported oil, would raise the costs for industries that use oil as their primary production input (for example, the petrochemical and paint industries). Consequently, domestic companies in those industries would find it more difficult to compete with foreign companies that would pay less for oil. To ameliorate that loss in competitiveness, imposing the same tax rate on the oil content of competing imports would be necessary. Such a tax would be cumbersome to design and administer and may violate the General Agreement on Tariffs and Trade.

Impose an Oil Import Fee. As an alternative to an excise tax on all oil, the Congress could impose the tax only on imported crude oil and refined petroleum products. An oil import fee of $5 per barrel would raise revenues by about $49 billion from 1996 through 2000.

An oil import fee would allow domestic suppliers to charge a higher price and still remain competitive with imports, providing an incentive to increase domestic crude oil production and a windfall to some domestic oil producers. Like the tax on all oil, the fee would also maintain incentives for conservation by increasing energy prices. Those effects would reduce U.S. dependence on foreign oil in the short term, although in the long term they might increase dependence by depleting U.S. oil supplies faster. Domestic and foreign oil are relatively close substitutes and, therefore, the difference in the prices consumers would pay for them would be slight. But foreign producers would receive a lower net price than domestic producers because of the fee. A large portion of that difference between the net price that domestic and foreign producers would receive represents a transfer of income from domestic consumers to domestic producers. Consequently, the federal government would receive only about half of the increase in consumers' expenditures for oil under an import fee because the United States imports nearly half of the oil it consumes and demand is insensitive to price in the short run.

Because an oil import fee would reduce U.S. demand for imported oil, important U.S. trading partners might object to it. Under the terms of the United States-Canada Free Trade Agreement, Canadian oil imports would be exempt from an import fee. However, a similar exemption does not apply to Mexican oil under the North American Free Trade Agreement. Because imports from Canada now account for almost 14 percent of U.S. oil imports, the Canadian exemption would reduce the fee's revenue potential substantially. Legislation implementing a fee would require special rules to prevent other countries from avoiding the tax by shipping oil through Canada.

Increase Motor Fuel Excise Taxes. Federal motor fuel taxes were increased by 4.3 cents per gallon in the Omnibus Budget Reconciliation Act of 1993. They are currently 18.4 cents per gallon of gasoline and 24.4 cents per gallon of diesel fuel. Revenue from 6.8 cents per gallon goes into the general fund until September 30, 1995; after that, revenue from 4.3 cents per gallon will go to the general fund. The remaining revenue goes into the Highway Trust Fund and several related trust funds.

State governments also impose gasoline and diesel taxes, ranging from 7.5 cents to 27.75 cents per gallon. However, in comparison with motor fuel tax rates in other countries, many of which are well over $1 a gallon, U.S. tax rates are still among the lowest in the world.

The average national price of all grades of gasoline has dropped from a peak of about $1.40 per gallon in March 1981 to about $1.20 in the fall of 1994. That represents a 14 percent price reduction in nominal terms and 46 percent in real terms. Therefore, an additional tax of 12 cents or even 50 cents per gallon would not put the total cost of gasoline above what consumers have already experienced in real terms.

A tax increase would reduce consumption of gasoline and diesel fuel by encouraging people to drive less or purchase more fuel-efficient cars and trucks. In addition, the tax would offset, though imperfectly, the costs of pollution and road congestion that automobile use produces. A rate increase on motor fuel taxes would not adversely affect U.S. producers relative to foreign producers because final consumers and the domestic transportation industry purchase most of the motor fuel.

Increasing tax rates on motor fuels would impose an added burden on the trucking industry and on people who commute long distances by car, who are not necessarily the highway users who impose the highest costs of pollution and congestion on others. Pollution and congestion costs are much higher in densely populated areas, primarily in the Northeast and coastal California, whereas per capita consumption of motor fuel is highest in rural areas. A 50 cent tax increase would produce significant adjustment costs for people and businesses who have based decisions about where they live and work and their choice of vehicle on low gasoline prices. Phasing in the tax increase, however, would reduce those costs by allowing businesses and consumers more time to adjust.

Each additional penny of tax would generate roughly $1 billion in revenues per year. A 12 cent increase would raise revenue by about $12 billion per year. Alternatively, five successive annual 10 cent increases would raise about $50 billion per year after being fully phased in.

To reduce the deficit, the Congress could allocate the increased revenues to the general fund, as it did with a portion of the added revenues from the rate increases in 1990 and 1993, rather than using the additional revenues to finance additional highway spending.

REV-37 IMPOSE EXCISE TAXES ON WATER POLLUTANTS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Impose a Tax on Biological Oxygen Demand	1.2	1.8	1.8	1.8	1.8	8.4
Impose a Tax on Toxic Water Pollutants	0.4	0.6	0.6	0.6	0.6	2.8

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll taxes.

Major facilities that discharge pollutants directly into water or indirectly into sewer systems are currently subject to regulations that specify pollution abatement technology or impose concentration limits on their discharges. Taxes on water pollutants discharged by those facilities could provide a significant source of revenue and could encourage further reductions in pollution below the level that current regulations require. Generally, firms subject to water pollution standards do not pay taxes or fees on effluents (discharges) that regulations still allow. There are two major types of water pollutants: biological oxygen demand (BOD) and toxics. One option is to impose a tax on BOD discharges. BOD is a common measure of water quality because excessive levels of BOD make it difficult to sustain aquatic life. (One BOD equals one milligram of oxygen consumed per 2.2 pounds of effluent.) A second option would impose a tax of varying rates on certain toxic discharges.

Taxes can reduce pollution in a cost-effective manner because they encourage firms with the lowest abatement costs to reduce pollution, while allowing firms with high abatement costs to continue polluting and pay the tax. Reductions in discharges caused by the tax would increase welfare if the additional abatement costs were less than or equal to the social benefits from reduced pollution levels. However, accurate estimates of additional social benefits from reducing pollution levels do not exist in many cases. In addition, imposing a tax on one class of pollutants might reduce other pollutants because some wastewater treatment processes reduce several pollutants simultaneously. Constitutional issues concerning federal taxation of local governments may arise, however, requiring direct taxation of primary sources that discharge to publicly owned treatment works (POTWs) rather than taxing the POTWs themselves.

Tax on Biological Oxygen Demand. BOD measures the effect of pollutants that encourage algae growth, which in turn depletes oxygen necessary to sustain much aquatic life. Most of the high-volume dischargers (sometimes referred to as point sources) are POTWs, paper and pulp mills, food processors, metal producers, and chemical plants. Discharges by point sources total about 10.6 million pounds of effluent per day. About 9.6 million pounds of that amount are discharged by publicly owned treatment works.

The cost of controlling discharges at POTWs and many industries subject to the Clean Water Act regulations averages about 50 cents to 75 cents per pound of effluent removed. A charge on BOD discharges could encourage manufacturing facilities and POTWs that face lower abatement costs to reduce pollution. Assuming effluents record an average concentration of 22 BOD, a tax of about 64 cents per pound of effluent discharged would raise $8.4 billion between 1996 and 2000. The revenue estimates cited here, however, assume that no additional abatement from

imposing the tax occurs and that firms cannot exceed allowable standards. If additional abatement was to occur, revenue collections would be lower.

Costs of administering a BOD water pollution excise tax would be small because allowable levels of BOD discharges are specified in the permits issued to every source of water pollution by state or federal governments. Levying a tax on effluents from POTWs, as well as from large industrial dischargers, would ensure that the tax base included all of the largest dischargers of BOD. If a tax could not be levied for constitutional reasons directly on POTW discharges, the POTWs themselves could collect the tax directly from polluters that discharge into sewer systems.

Tax on Toxic Water Pollutants. The manufacturing sector in the United States discharged more than 270 million pounds of toxics into water directly in 1992 and more than 380 million pounds of toxics into water indirectly through sewers. Toxic pollutants generally include organic chemicals (such as solvents and dioxins), metals (such as mercury and lead), and pesticides. Those toxics may pose a threat to the aquatic environment and to human health.

The amount of environmental harm that toxic water pollutants cause depends on their toxicity. The Environmental Protection Agency (EPA) has devised a weighing method to indicate the toxicity of various pollutants. Use of that weighing system makes it possible to measure the quantities of different types of toxics by their "toxic pound equivalents" (which the EPA defines as the pounds of the pollutant multiplied by its toxic weight). This option adopts tax rates developed by the Congressional Research Service in a study on the discharges of manufacturing firms in 1987 and applies those rates to 1992 discharges. The Congressional Research Service defined five categories of pollutants based on their toxicities. The tax rates varied from 0.65 cents per pound for the least toxic category of pollutants to $63.40 per pound for the most toxic category. Those rates correspond to a charge of $32.35 per toxic pound equivalent. The variable tax rates provide firms with a greater incentive to reduce their most toxic discharges.

According to the EPA, the cost of controlling another toxic pound equivalent varies among industries, ranging from $1.50 to $606 per toxic pound equivalent (in 1991 dollars). The tax, therefore, could encourage industries and firms with low abatement costs to reduce their toxic discharges. Assuming that discharges of toxics remain the same, the tax would raise $2.8 billion from 1996 through 2000. Revenues could be lower, however, if the amount of toxic pollutants the firms discharge decreases as a result of the tax. In addition, revenues would change when the toxic weights that are assigned to chemicals change. For example, this year's revenue estimate is considerably lower than last year's estimate because the EPA has decreased weights associated with many of the chemicals that are discharged in large quantities.

The Internal Revenue Service could use information that the EPA's Toxic Release Inventory (TRI) provides on toxic discharges by manufacturing firms to assess tax payments or the EPA could collect the tax on behalf of the Internal Revenue Service. An important consideration, however, is that the accuracy of TRI data is questionable. The TRI contains self-reported data, and many facilities that meet the reporting requirements fail to file reports or file inaccurate reports. To improve the accuracy of the TRI database and enhance enforcement, frequent auditing would be necessary.

REV-38 IMPOSE EXCISE TAXES ON AIR POLLUTANTS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Stationary Sources						
Impose a Tax of $400 per Ton on Sulphur Dioxide	4.3	6.5	6.5	6.5	6.5	30.3
Impose a Tax of $3,000 per Ton on Nitrogen Oxides	21.4	31.9	31.9	31.9	31.9	149.0
Impose a Tax of $2,000 per Ton on Particulate Matter	4.3	6.4	6.4	6.4	6.4	29.9
Impose a Tax of $5,000 per Ton on Volatile Organic Compounds	39.9	59.6	59.6	59.6	59.6	278.3
Mobile Sources						
Impose a One-Time Emission Tax (Averaging $250 per Vehicle) on New Automobiles and Light Trucks	1.9	2.8	2.8	2.8	2.8	13.1

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll taxes.

The Clean Air Act requires the Environmental Protection Agency (EPA) to establish National Ambient Air Quality Standards designed to protect public health and welfare. The EPA defines acceptable levels for six air pollutants: sulfur dioxide (SO_2), nitrogen oxides (NO_x), ozone (O_3), particulate matter (PM-10), carbon monoxide (CO), and lead (Pb). The pollutants SO_2 and NO_x are considered primarily responsible for acid rain, which the EPA believes degrades surface waters, damages forests and crops, and potentially increases the incidence of respiratory ailments. Large industrial sources, notably coal-fired electric utilities, emit significant quantities of those pollutants. Industrial production and the use of automobiles and trucks emit NO_x and volatile organic compounds (VOCs), which combine with sunlight and other compounds to produce ozone pollution. Electric utilities and motor vehicles emit particulate matter when they burn fossil fuels. Particulate matter can carry heavy metals and cancer-causing organic compounds into the lungs, thus increasing the incidence and severity of respiratory diseases. Carbon monoxide is produced primarily by motor vehicles and residential woodburning, and it can also pose direct health hazards. Exposure to lead may cause neurological disorders and cardiovascular disease. Discharges of lead were significantly reduced with the phaseout of leaded gasoline. In 1991, however, about 85 million people lived in areas that did not meet the EPA's National Ambient Air Quality Standards because of unacceptable levels of ozone, CO, or PM-10.

With some minor exceptions, firms subject to air pollution standards must incur the costs needed to reduce emissions to comply with regulations. Most firms do not, however, pay taxes or fees on emissions that regulations still allow, although major point

sources do pay approximately $400 million annually in user fees to cover program costs. The Clean Air Act, as amended in 1990, adopts a new acid rain control program that introduces a market-based emission allowance system to reduce SO_2 emissions. An allowance is a limited authorization to emit a ton of SO_2. Affected electric utilities are allotted tradable allowances based on their past fuel usage and statutory limitations on emissions. Once the allowances are allotted, the act requires that annual SO_2 emissions not exceed the number of allowances held by each utility plant. Firms may trade allowances among each other, bank them for future use, or purchase them through periodic auctions held by the EPA. The allowance market is structured to encourage firms with relatively low costs of abatement to reduce their emissions and sell surplus allowances to firms that have relatively high costs of abatement.

The incremental cost of controlling pollution for stationary sources varies, given the numerous industrial and other sources. The four options that tax pollution from stationary sources would base the tax rates on an estimate of the average cost of reducing an additional ton of pollution. Some firms with low abatement costs may reduce pollution below allowable standards in response to the taxes. The option that taxes emissions from mobile sources (vehicles) could also reduce pollution levels. (See REV-34 and REV-36 for other taxes that might reduce emissions of air pollutants.) Reductions in emissions caused by the taxes would increase welfare if additional abatement costs were less than or equal to the social benefits from reduced pollution levels. However, accurate estimates of additional social benefits from reducing pollution levels do not exist in many cases.

The revenue estimates cited here, however, assume that no additional abatement from imposing the taxes occurs and that firms cannot exceed allowable standards. If additional abatement was to occur, revenue collections would be lower.

Tax Emissions of SO_2 and NO_x from Stationary Sources. Imposing taxes of $400 per ton of SO_2 emissions and $3,000 per ton of NO_x emissions from all stationary sources would raise roughly $30 billion for SO_2 and $149 billion for NO_x from 1996 through 2000. Basing the tax on the terms granted in air pollution permits, which all polluting firms must acquire, would minimize costs of administration. The Internal Revenue Service (IRS) could collect the tax itself or the state and local government agencies that issue pollution permits could collect the tax on behalf of the IRS. The present monitoring and reporting system for stationary sources that the EPA and state regulators operate could be used to enforce the tax. If polluters' actual emission levels were lower than permitted levels, polluters could apply for revised permits based on those actual levels. If the tax was based on permitted emissions levels, it would be equivalent to the government's selling pollution permits at their fair market price.

The proposed tax on SO_2 could reduce pollution below the mandated amounts contained in the Clean Air Act Amendments of 1990 (CAAA). Some electric utilities and manufacturing plants might switch to lower-sulfur coals because that would be less costly than paying the tax, and others might choose to operate their most heavily emitting plants less frequently or to install new SO_2 control devices. The tax system could interact with the tradable allowance system, thereby allowing the government to collect revenues based on emission levels and firms to collect the proceeds from the sale of allowances. (The average sale price of allowances would probably adjust downward in the event of a tax.) The tax on NO_x could also reduce emissions below mandated levels contained in the CAAA if some firms adopt currently available abatement techniques whose capitalized costs per unit of reduced emissions are lower than the tax rate.

Tax Emissions of PM-10 from Stationary Sources. A tax of $2,000 per ton of particulate matter would raise about $30 billion from 1996 through 2000, based on levels of emissions that the EPA projects under current regulations. Some electric utilities and manufacturing plants might install improved electrostatic precipitators, wet scrubbers, or other equipment that reduces PM-10 emissions to lower their tax burdens. This tax could be administered in the same manner as the taxes on SO_2 and NO_x.

Tax Emissions of VOCs from Stationary Sources. Stationary sources of volatile organic compounds range from huge industrial facilities such as chemical plants, petroleum refineries, and coke ovens to small sources such as bakeries and dry cleaners. Their vast number and diversity make it difficult to estimate

emissions and costs of abatement. A tax of $5,000 per ton on all stationary-source VOC emissions might promote some abatement and would generate about $278 billion in revenues from 1996 through 2000.

The advantage of a broad-based tax on VOCs is that it would capture small sources, which the EPA estimates are responsible for approximately 80 percent of all emissions from stationary sources. Because stationary sources emitting less than 2.5 tons of VOCs per year are not currently subject to federal regulation, a broad-based VOC tax would be administratively more difficult to carry out than a tax on large sources alone. Assessing the tax on small sources through technology-based estimates of emissions rather than measured emissions would reduce administrative costs, but make the incentives less precise. Alternatively, imposing the tax only on large stationary sources would raise about $12 billion annually.

Tax Emissions of NO_x, VOCs, and CO from Mobile Sources. A one-time tax imposed on new automobiles and light trucks could be based on grams of NO_x, VOCs, and CO emitted per mile as estimated under the EPA emission certification tests required on every new vehicle. The tax could be administered like the "gas guzzler" excise tax. The EPA would determine the tail-pipe emissions for each new model light-duty vehicle, and the tax would be based on those emission rates. The auto dealer would collect the tax on behalf of the Internal Revenue Service from the vehicle's purchaser.

Such a tax averaging $250 per vehicle could raise $13 billion in revenues from 1996 through 2000. The revenue estimates presented here are based on projected new car sales and assume that new cars meet, on average, current tail-pipe standards. Revenues could be lower than projected if the tax induced consumers to purchase more fuel-efficient vehicles. Also, if new cars became cleaner over time, revenues would be lower than projected. Vehicles made in earlier years have been excluded from the estimate because of the administrative problems of collecting a tax on older vehicles. A disadvantage of excluding them, however, is that earlier-year vehicles represent more than 90 percent of the light-duty vehicles in use and an even greater share of emissions. In addition, the tax would encourage people to delay purchases of new vehicles by raising their price.

REV-39 TAX ADDITIONAL OZONE-DEPLETING CHEMICALS

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Impose an ODC Tax on Methyl Bromide at Current Rates	0.1	0.2	0.2	0.2	0.2	0.9
Impose an ODC Tax on HCFCs at Current Rates	0.1	0.1	0.1	0.2	0.2	0.7

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues.

In 1989, the Congress imposed an excise tax on chlorofluorocarbons (CFCs) and halons, chemicals with high potential to deplete ozone. The Congress added carbon tetrachloride and methyl chloroform to the list of chemicals subject to tax in 1990. It later increased the tax rates on these ozone-depleting chemicals (ODCs) in the Energy Policy Act of 1992. The tax rates differ among the various ODCs, with the rate on any particular chemical being the product of the base tax rate and the ODC's ozone-depletion factor--a measure of the chemical's potential to damage the ozone layer. The base tax rate is $5.35 per pound of ODC in 1995, increasing to $7.60 per pound in 2000. The ozone-depletion factors for the ODCs currently subject to tax range from 0.1 (for methyl chloroform) to 10 (for halon 1301). Most of the CFCs have ozone-depletion factors around 1. The chemicals currently taxed are also regulated by the Environmental Protection Agency (EPA) and are scheduled to be phased out by January 1, 1996. (Halon was phased out by January 1, 1994.)

The EPA regulates additional ODCs that are not currently taxed--namely, methyl bromide and hydrochlorofluorocarbons (HCFCs). At the end of 1992, more than 100 countries recognized the concerns of scientists about those two types of ODCs and added them to the Montreal Protocol, a 1987 accord that set international production limits and phaseouts on most of the known harmful ODCs. Expanding the ODC tax to cover those additional chemicals would lead to more consistent treatment among the various ODCs. The ozone-depletion factor for methyl bromide is around 0.7, whereas the factors for HCFCs are much lower and fall in the 0.01 to 0.09 range.

Broadening the tax base to include methyl bromide and HCFCs could raise $1.6 billion from 1996 through 2000. The new taxes would raise prices of the chemicals and some related retail prices. Coupled with the regulatory phaseouts, those taxes would work to encourage further development of substitutes or alternative processes.

Methyl bromide is used in agriculture as a pesticide and multipurpose fumigant. Its most prominent agricultural use is as a soil (fungicide) fumigant. Scientific evidence of its ozone-depletion factor (around 0.7) suggests that methyl bromide is more harmful than some of the chemicals that are taxed under current law. EPA regulations freeze methyl bromide production at 1991 levels and phase out the production and importation of methyl bromide by the year 2001. Taxing the chemical at current-law rates could raise $0.9 billion from 1996 through 2000. The extent to which the tax would encourage the use of alternatives, however, is unclear. Substitutes may not currently exist for some uses of methyl bromide. Whether the tax is paid (through continued use of methyl bromide) or avoided (through substitution for methyl bromide), the tax might reduce the supply and thereby raise the consumer prices of certain types of produce, such as tomatoes, strawberries, and grapes.

HCFCs are considered to be valuable near-term substitutes for certain applications of CFCs--for example, as a refrigerant in chillers or as a blowing agent in foam. HCFCs have less than 10 percent of the ozone-depletion potential of CFCs. The potential is not negligible, however, because of the chlorine still present in HCFCs. As a result, EPA regulations substantially reduce the production of HCFCs between 2003 and 2020 and completely phase out remaining production by 2030. Although applying the ODC tax to HCFCs would result in a much lower tax rate than is applied to CFCs, taxing HCFCs at current-law rates could raise $0.7 billion from 1996 through 2000 and could further spur the adoption or development of alternatives. Hydrofluorocarbons (HFCs), which contain no chlorine, are already being manufactured and used in certain industrial applications as replacements for both CFCs and HCFCs. Unfortunately, HFCs are not currently substitutable for all uses of HCFCs. For example, although HFCs are used in at least some types of air conditioners and refrigerators, they are not used in the construction of cellular rigid-foam insulation. A tax on HCFCs would therefore be likely to have different incentive effects depending on industrial use. In addition, although HFCs do not deplete the ozone, some are known to have greater global-warming potential than HCFCs as a result of their longer atmospheric lifetimes, and some may be inferior in terms of energy efficiency. Consequently, shifting from HCFCs to HFCs may involve trading one type of environmental risk for another. HFCs are also more expensive to produce.

Appendixes

Appendix A

Estimated Savings in the Department of Defense Budget for Selected National Defense Options

Table A-1 shows estimated savings in the national defense budget for options in Chapter 2 that affect military or civilian pay. Estimated savings in the defense budget for those options would be higher because certain payments by the Department of Defense result in intragovernmental transfers that are offset within the total federal budget. The most significant of those payments are the accrual payments for military retirement and the government's contribution for civilian retirement systems.

Table A-1.
Savings in the DoD Budget for Selected Options in Budget Function 050

	Annual Savings from the 1995 Plan (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
DEF-01 REDUCE NUCLEAR DELIVERY SYSTEMS WITHIN OVERALL LIMITS OF START II						
Budget Authority	50	490	600	760	950	2,850
Outlays	-70	30	270	550	810	1,590
DEF-05 REDUCE THE NUMBER OF AIRCRAFT CARRIERS AND AIR WINGS TO 10						
Budget Authority	520	1,070	1,110	1,150	1,190	5,040
Outlays	390	880	1,010	1,090	1,150	4,520
DEF-07 ELIMINATE FRIGATES FROM THE NAVAL FORCE						
Budget Authority	90	270	470	680	870	2,380
Outlays	70	220	390	590	780	2,050

(Continued)

Table A-1.
Continued

	Annual Savings from the 1995 Plan (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
DEF-11 REDUCE AIR FORCE TACTICAL FORCES						
Budget Authority	250	510	530	540	560	2,390
Outlays	180	420	480	520	540	2,140
DEF-14 RETIRE EXCESS KC-135 TANKERS						
Budget Authority	40	130	220	310	420	1,120
Outlays	30	110	190	290	390	1,010
DEF-15 MAKE THE ARMY RESPONSIBLE FOR CLOSE AIR SUPPORT						
Budget Authority	140	350	630	1,080	1,340	3,540
Outlays	110	300	540	930	1,210	3,090
DEF-17 REDUCE THE NUMBER OF ARMY LIGHT DIVISIONS						
Budget Authority	410	1,370	2,480	3,480	3,980	11,720
Outlays	350	1,200	2,240	3,190	3,740	10,720
DEF-23 RESTRUCTURE RESERVE COMPENSATION						
Budget Authority	145	270	460	655	860	2,390
Outlays	140	255	435	625	815	2,270
DEF-25 CLOSE THE UNIFORMED SERVICES UNIVERSITY OF THE HEALTH SCIENCES						
Budget Authority	20	30	50	90	100	290
Outlays	10	30	50	80	90	270
DEF-26 ADOPT HMO STAFFING PATTERNS IN MILITARY MEDICAL FACILITIES						
Budget Authority	20	60	100	130	130	440
Outlays	20	60	100	130	130	430

(Continued)

Table A-1.
Continued

	Annual Savings from the 1995 Plan (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
DEF-28 CONSOLIDATE PILOT TRANING AND DELAY BUYING THE JOINT PRIMARY AIRCRAFT TRAINING SYSTEM						
Budget Authority	200	390	640	750	840	2,820
Outlays	30	160	370	540	710	1,810
DEF-31 INCREASE RELIANCE ON PRIVATE-SECTOR HOUSING FOR MILITARY FAMILIES						
Budget Authority	660	660	650	640	610	3,220
Outlays	100	340	510	620	660	2,230
DEF-32 ELIMINATE FEDERAL SUPPORT OF COMMISSARIES						
Budget Authority	120	240	360	490	500	1,720
Outlays	90	210	320	450	490	1,570
DEF-33 REDUCE THE DoD CIVILIAN ACQUISITION WORKFORCE						
Budget Authority	55	210	570	1,110	1,900	3,845
Outlays	55	205	560	1,095	1,880	3,795

NOTE: For all national defense options not appearing in this table, savings in defense budget function 050 are the same as total federal savings.

Appendix B

Estimated Savings from the Administration's 1996 Request for Selected National Defense Options

In its fiscal year 1996 budget request, the Administration has proposed significant changes to its plan that would affect savings from some of the defense options presented in Chapter 2. The savings from those options for which the Congressional Budget Office was able to obtain sufficient information on the new plan to make an estimate are shown in Table B-1. For options that involve changes in military or civilian pay, savings are shown for both the federal budget and the Department of Defense budget. (Certain payments by the Department of Defense result in intragovernmental transfers that are offset within the total federal budget.)

Table B-1.
Savings from CBO's Estimates of the Administration's 1996 Plan for Selected Options in Budget Function 050

	Annual Savings from the 1996 Plan (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
DEF-01 REDUCE NUCLEAR DELIVERY SYSTEMS WITHIN OVERALL LIMITS OF START II						
In the Federal Budget						
Budget Authority	280	650	760	870	1,760	4,320
Outlays	40	240	470	680	1,010	2,440
In the Defense Budget						
Budget Authority	270	650	770	900	1,810	4,400
Outlays	40	250	490	700	1,050	2,530
DEF-02 TERMINATE PRODUCTION OF D5 MISSILES AFTER 1996						
Budget Authority	130	360	360	410	1,130	2,390
Outlays	20	90	210	310	500	1,130

(Continued)

Table B-1.
Continued

	Annual Savings from the 1996 Plan (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
DEF-07 ELIMINATE FRIGATES FROM THE NAVAL FORCE						
In the Federal Budget						
Budget Authority	100	310	540	770	960	2,680
Outlays	70	240	440	660	850	2,260
In the Defense Budget						
Budget Authority	110	350	600	860	1,080	3,000
Outlays	80	280	510	750	970	2,590
DEF-08 REDUCE PROCUREMENT OF DDG-51 DESTROYERS						
Budget Authority	0	950	0	1,010	1,050	3,010
Outlays	0	50	240	280	520	1,090
DEF-10 CANCEL THE MARINE CORPS'S V-22 AIRCRAFT PROGRAM AND BUY CH-53E HELICOPTERS						
Budget Authority	620	1,100	930	820	700	4,170
Outlays	390	590	700	740	680	3,100
DEF-12 CANCEL THE AIR FORCE'S F-22 AIRCRAFT PROGRAM						
Budget Authority	2,150	2,050	2,300	2,120	2,860	11,480
Outlays	1,000	1,750	1,670	1,570	1,700	7,690
DEF-13 BUY NO MORE THAN 40 C-17s AND BUY COMMERCIAL AIRLIFTERS INSTEAD						
Budget Authority	-520[a]	1,470	980	2,140	2,270	6,340
Outlays	-30	-30	240	740	1,240	2,160
DEF-18 CANCEL THE ARMY'S TANK UPGRADE PROGRAM AND LAY AWAY PRODUCTION FACILITIES						
Budget Authority	480	510	410	560	590	2,550
Outlays	30	230	370	390	450	1,470

(Continued)

Table B-1.
Continued

	Annual Savings from the 1996 Plan (Millions of dollars)					Cumulative Five-Year Savings
	1996	1997	1998	1999	2000	
DEF-19 CUT SPENDING FOR DUAL-USE TECHNOLOGY PROGRAMS TO HISTORICAL LEVELS						
Budget Authority	800	600	600	600	600	3,200
Outlays	350	580	600	580	590	2,700
DEF-28 CONSOLIDATE PILOT TRAINING AND DELAY BUYING THE JOINT PRIMARY AIRCRAFT TRAINING SYSTEM						
In the Federal Budget						
Budget Authority	70	200	340	410	600	1,620
Outlays	0	90	240	340	440	1,120
In the Defense Budget						
Budget Authority	70	210	370	440	640	1,730
Outlays	10	100	270	370	480	1,220
DEF-30 REDUCE FUNDING FOR DOE'S CLEANUP PROGRAM						
Budget Authority	670	630	560	560	560	2,970
Outlays	330	550	600	570	560	2,600

NOTE: If an option does not appear in this table, use the savings estimates presented in Chapter 2.

a. In its 1996 budget, the Administration reduced the amount of funding for nondevelopmental airlift aircraft and strategic airlift by some $727 million from its plan of a year ago. As a consequence, spending for commercial wide-body aircraft in 1996 exceeds savings from canceling the C-17.

Appendix C

Spending Options by Budget Function

050 National Defense

150 International Affairs

250 General Science, Space, and Technology

270 Energy

300 Natural Resources and Environment

350 Agriculture

370 Commerce and Housing Credit

400 Transportation

450 Community and Regional Development

600 Income Security

Glossary

This glossary defines economic and budgetary terms as they relate to this report. Some entries sacrifice precision for brevity and clarity to the lay reader. Where appropriate, sources of data for economic variables are indicated as follows:

BLS denotes the Bureau of Labor Statistics in the Department of Labor;

CBO denotes the Congressional Budget Office;

NBER denotes the National Bureau of Economic Research.

appropriation act: A statute under the jurisdiction of the House and Senate Committees on Appropriations that provides budget authority. Enactment generally follows adoption of authorizing legislation unless the authorization itself provides the budget authority. Currently, 13 regular appropriation acts are enacted each year. When necessary, the Congress may enact supplemental or continuing appropriations.

authorization: A substantive law that sets up or continues a federal program or agency. Authorizing legislation is normally a prerequisite for appropriations. For some programs, the authorizing legislation itself provides the authority to incur obligations and make payments.

Balanced Budget and Emergency Deficit Control Act of 1985: Also known as Gramm-Rudman-Hollings or the Balanced Budget Act, this law set forth specific deficit targets and a sequestration procedure to reduce spending if the targets were exceeded. The Budget Enforcement Act of 1990 established new budget procedures through fiscal year 1995 as well as revised targets, which exclude the Social Security trust funds. The Omnibus Budget Reconciliation Act of 1993 further extended various provisions of the Balanced Budget Act, without including fixed deficit targets beyond fiscal year 1995. See **discretionary spending caps** and **pay-as-you-go**.

baseline: A benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending. As specified in the Budget Enforcement Act of 1990 (BEA), the baseline for revenues and entitlement spending generally assumes that laws now on the statute books will continue. The discretionary spending projections are based on the discretionary spending caps set by the BEA in 1995 through 1998. The *baseline with discretionary inflation* adjusts discretionary appropriations for inflation after 1998; the *baseline without discretionary inflation* does not.

budget authority: Legal authority to incur financial obligations that will result in the spending of federal government funds. Budget authority may be provided in an authorization or an appropriation act. Offsetting collections, including offsetting receipts, constitute negative budget authority.

budget deficit: Amount by which budget outlays exceed budget revenues during a given period.

Budget Enforcement Act of 1990 (BEA): Title XIII of the Omnibus Budget Reconciliation Act of 1990. This act amended both the Congressional Budget Act of 1974 and the Balanced Budget and Emergency Deficit Control Act of 1985. The BEA provides for new budget targets, sequestration procedures, pay-as-you-go procedures, credit reform, and various other changes. The discretionary spending caps and the pay-as-you-go process were extended through 1998 by the Omnibus Budget Reconciliation Act of 1993. See **discretionary spending caps** and **pay-as-you-go**.

budget function: One of 20 areas into which federal spending and credit activity are divided. National needs are grouped into 17 broad budget functions, including national defense, international affairs, energy, agriculture, health, income security, and general government. Three functions--net interest, allowances, and undistributed offsetting receipts--do not address national needs but are included to complete the budget.

budget resolution: A resolution, passed by both Houses of Congress, that sets forth a Congressional budget plan for the next five years. The plan must be carried out through subsequent legislation, including appropriations and changes in tax and entitlement laws. The resolution sets guidelines for Congressional action, but it is not signed by the President and does not become law. The Congressional Budget Act of 1974 established a number of mechanisms that are designed to hold spending and revenues to the targets established in the budget resolution.

budgetary resources: All sources of budget authority that are subject to sequestration. Budgetary resources include new budget authority, unobligated balances, direct spending authority, and obligation limitations. See **sequestration**.

compensation: All income due to employees for their work during a given period. Compensation includes wages and salaries as well as fringe benefits and employers' share of social insurance taxes. (Bureau of Economic Analysis)

constant dollar: Measured in terms of prices of a base period--currently 1987 for most purposes--to remove the effect of inflation. Compare with **current dollar**.

credit reform: A revised system of budgeting for federal credit activities that focuses on the cost of subsidies conveyed in federal credit assistance. This process was authorized by the Federal Credit Reform Act of 1990, which was part of the Budget Enforcement Act of 1990.

credit subsidies: The estimated long-term costs to the federal government of direct loans or loan guarantees calculated on the basis of net present value, excluding administrative costs and any incidental effects on governmental receipts or outlays. For direct loans, the subsidy cost is the net present value of loan disbursements minus repayments of interest and principal, adjusted for estimated defaults, prepayments, fees, penalties, and other recoveries. For loan guarantees, the subsidy cost is the net present value of the estimated payments by the government to cover defaults and delinquencies, interest subsidies, or other payments, offset by any payments to the government, including origination and other fees, penalties, and recoveries. See **present value**.

current dollar: Measured in the dollar value--reflecting then-prevailing prices--of the period under consideration. Compare with **constant dollar**.

debt held by the public: Debt issued by the federal government and held by nonfederal investors (including the Federal Reserve System).

debt service: Payment of scheduled interest obligations on outstanding debt.

defense spending: See **discretionary spending**.

deposit insurance: The guarantee by a federal agency that an individual depositor at a participating depository institution will receive the full amount of the deposit (up to $100,000) if the institution becomes insolvent.

direct spending: The Budget Enforcement Act of 1990 defines direct spending as (a) budget authority provided by an authorization, (b) entitlement authority (including mandatory spending contained in appropriation acts), and (c) the Food Stamp program. A synonym is **mandatory spending**. Compare with **discretionary spending**.

discretionary spending: Spending for programs whose funding levels are determined through the appropriation process. The Congress has the discretion each year to determine how many dollars will be devoted to continuing current programs and funding new ones. The Budget Enforcement Act of 1990 divided discretionary spending among three categories: defense, international, and domestic. Compare with **direct spending**.

Defense discretionary spending consists primarily of the military activities of the Department of Defense, which are funded in the defense and military construction appropriation bills. It also includes the defense-related functions of other agencies, such as the Department of Energy's nuclear weapons programs.

International discretionary spending encompasses spending for foreign economic and military aid, the activities of the Department of State and the U.S. Information Agency, and international financial programs, such as the Export-Import Bank of the United States.

Domestic discretionary spending includes most government activities in science and space, transportation, medical research, environmental protection, and law enforcement, among other spending programs. Funding for those programs is provided in 10 of the annual appropriation bills.

discretionary spending caps: Annual ceilings on budget authority and outlays for discretionary programs defined in the Balanced Budget Act of 1985, as amended by the Budget Enforcement Act of 1990 and the Omnibus Budget Reconciliation Act of 1993. For fiscal years 1991 through 1993, the caps were divided among the three categories of discretionary spending--defense, international, and domestic. For fiscal years 1994 through 1998, there is one cap for all discretionary spending. Discretionary spending caps are enforced through Congressional rules and sequestration procedures.

domestic discretionary spending: See **discretionary spending**.

entitlements: Programs that make payments to any person, business, or unit of government that seeks the payments and meets the criteria set in law. The Congress controls these programs indirectly by defining eligibility and setting the benefit or payment rules. Although the level of spending for these programs is controlled by the authorizing legislation, funding may be provided in either an authorization or an appropriation act. The best-known entitlements are the major benefit programs, such as Social Security and Medicare; other entitlements include farm price supports and interest on the federal debt. See **direct spending**.

excise tax: A tax levied on the purchase of a specific type of good or service, such as tobacco products or telephone services.

fiscal policy: The government's choice of tax and spending programs, which influences the amount and maturity of government debt as well as the level, composition, and distribution of national output and income. An "easy" fiscal policy stimulates the short-term growth of output and income, whereas a "tight" fiscal policy restrains their growth. Movements in the standardized-employment deficit constitute one overall indicator of the tightness or ease of federal fiscal policy; an increase relative to potential gross domestic product suggests fiscal ease, whereas a decrease suggests fiscal restriction. The President and the Congress jointly determine federal fiscal policy.

fiscal year: A yearly accounting period. The federal government's fiscal year begins October 1 and ends September 30. Fiscal years are designated by the calendar years in which they end--for example, fiscal year 1995 began October 1, 1994, and will end on September 30, 1995.

GDP: See **gross domestic product**.

GNP: See **gross national product**.

grants: Transfer payments from the federal government to state and local governments or other recipients to help fund projects or activities that do not involve substantial federal participation.

grants-in-aid: Grants from the federal government to state and local governments to help provide for programs of assistance or service to the public.

gross domestic product (GDP): The total market value of all goods and services produced domestically during a given period. The components of GDP are consumption, gross domestic investment, government purchases of goods and services, and net exports. (Bureau of Economic Analysis)

gross national product (GNP): The total market value of all goods and services produced in a given period by labor and property supplied by residents of a country, regardless of where the labor and property are located. GNP differs from GDP primarily by including the excess of capital income that residents earn from investments abroad minus capital income that nonresidents earn from domestic investment.

inflation: Growth in a measure of the general price level, usually expressed as an annual rate of change.

infrastructure: Government-owned capital goods that provide services to the public, usually with benefits to the community at large as well as to the direct user. Examples include schools, roads, bridges, dams, harbors, and public buildings.

investment: *Physical investment* is the current product set aside during a given period to be used for future production; in other words, an addition to the stock of capital goods. As measured by the national income and product accounts, private domestic investment consists of investment in residential and nonresidential structures, producers' durable equipment, and the change in business inventories. *Financial investment* is the purchase of a financial security. *Investment in human capital* is spending on education, training, health services, and other activities that increase the productivity of the workforce. Investment in human capital is not treated as investment in the national income and product accounts.

long-term interest rate: Interest rate earned by a note or bond that matures in 10 or more years.

mandatory spending: Another term for **direct spending**.

marginal tax rate: Tax rate that applies to an additional dollar of taxable income.

means of financing: Sources of financing federal deficits or uses of federal surpluses. The largest means of financing is normally federal borrowing from the public, but other means of financing include any transaction that causes a difference between the federal (including off-budget) surplus or deficit and the change in debt held by the public. The means of financing include changes in checks outstanding and Treasury cash balances, seigniorage (that is, government revenue from the manufacture of money), and the transactions of the financing accounts established under credit reform.

means-tested programs: Programs that provide cash or services to people who meet a test of need based on income and assets. Most means-tested programs are entitlements--for example, Medicaid, the Food Stamp program, Supplemental Security Income, family support, and veterans' pensions--but a few, such as subsidized housing and various social services, are funded through discretionary appropriations.

national income and product accounts (NIPAs): Official U.S. accounts that detail the composition of GDP and how the costs of production are distributed as income. (Bureau of Economic Analysis)

national saving: Total saving by all sectors of the economy: personal saving, business saving (corporate after-tax profits not paid as dividends), and government saving (budget surplus or deficit--indicating dissaving--of all government entities). National saving represents all income not consumed, publicly or privately, during a given period. (Bureau of Economic Analysis)

net interest: *In the federal budget*, net interest includes federal interest payments to the public as recorded in budget function 900. Net interest also includes, as an offset, interest income received by the government on loans and cash balances. *In the national income and product accounts* (NIPAs), net interest is the income component of GDP paid as interest--primarily interest that domestic businesses pay, minus interest they receive. The NIPAs treat government interest payments as transfers, so they are not part of GDP.

nominal: Measured in the dollar value (as in nominal output, income, or wage rate) or market terms (as in nominal exchange or interest rate) of the period under consideration. Compare with **real**.

off-budget: Spending or revenues excluded from the budget totals by law. The revenues and outlays of the two Social Security trust funds and the transactions of the Postal Service are off-budget and (except for discretionary Social Security administrative costs) are not included in any Budget Enforcement Act calculations.

offsetting receipts: Funds collected by the federal government that are recorded as negative budget authority and outlays and credited to separate receipt accounts. More than half of offsetting receipts are intragovernmental receipts that reflect agencies' payments to retirement and other funds on behalf of their employees; these receipts simply balance payments elsewhere in the budget. An additional category of receipts (proprietary receipts) come from the public and generally represent voluntary, business-type transactions. The largest items are the flat premiums for Supplementary Medical Insurance (Part B of Medicare), timber and oil lease receipts, and proceeds from the sale of electric power.

outlays: The liquidation of a federal obligation, generally by issuing a check or disbursing cash. Sometimes obligations are liquidated (and outlays occur) by issuing agency promissory notes, such as those of the former Federal Savings and Loan Insurance Corporation. Unlike outlays for other categories of spending, outlays for interest on the public debt are counted when the interest is earned, not when it is paid. Outlays may be for payment of obligations incurred in previous fiscal years or in the same year. Outlays, therefore, flow in part from unexpended balances of prior year budget authority and in part from budget authority provided for the current year.

pay-as-you-go (PAYGO): A procedure required in the Budget Enforcement Act of 1990 to ensure that, for fiscal years 1991 through 1995, legislation affecting direct spending and receipts does not increase the deficit. Pay-as-you-go is enforced through Congressional rules and sequestration procedures. The pay-as-you-go process was extended through fiscal year 1998 by the Omnibus Budget Reconciliation Act of 1993.

potential real GDP: The highest level of real GDP that could persist for a substantial period without raising the rate of inflation. CBO's calculation relates potential GDP to the nonaccelerating inflation rate of unemployment, which is the unemployment rate consistent with a constant inflation rate. (CBO)

present value: A single number that expresses a flow of current and future income (or payments) in terms of an equivalent lump sum received (or paid) today. The calculation of present value depends on the rate of interest. For example, given an interest rate of 5 percent, today's 95 cents will grow to $1 next year. Hence, the present value of $1 payable a year from today is only 95 cents.

productivity: Average real output per unit of input. *Labor productivity* is average real output per hour of labor. The growth of labor productivity is defined as the growth of real output that is not explained by the growth of labor input alone. *Total factor productivity* is average real output per unit of combined labor and capital inputs. The growth of total factor productivity is defined as the growth of real output that is not explained by the growth of labor and capital. Labor productivity and total factor productivity differ in that increases in capital per worker would raise labor productivity but not total factor productivity. (BLS)

real: Adjusted to remove the effect of inflation. *Real (constant-dollar) output* represents volume, rather than dollar value, of goods and services. *Real income* represents power to purchase real output. *Real data* are usually constructed by dividing the corresponding nominal data, such as output or a wage rate, by a price index or deflator. *Real interest rate* is a nominal interest rate minus the expected inflation rate. Compare with **nominal.**

recession: A phase of the business cycle extending from a peak to the next trough--usually lasting six months to a year--characterized by widespread declines in output, income, employment, and trade in many sectors of the economy. Real GDP usually falls throughout a recession. See **business cycle**. (NBER)

reconciliation: A process the Congress uses to make its tax and spending legislation conform with the targets established in the budget resolution. The budget resolution may contain reconciliation instructions directing certain Congressional committees to achieve deficit reduction through changes in tax or spending programs under their jurisdiction. Legislation to implement the reconciliation instructions is usually combined in one comprehensive bill. The reconciliation process primarily affects taxes, entitlement spending, and offsetting receipts. As a general rule, decisions on discretionary programs are determined separately through the appropriation process, which is also governed by allocations in the budget resolution.

recovery: A phase of the business cycle that lasts from a trough until overall economic activity returns to the level it had reached at the previous peak. See **business cycle**. (NBER)

revenues: Funds collected from the public arising from the sovereign power of the government. Revenues consist of receipts from income taxes (individual and corporate), excise taxes, and estate and gift taxes; social insurance contributions; customs duties; miscellaneous receipts such as Federal Reserve earnings, gifts, and contributions; and fees and fines. Revenues are also known as federal governmental receipts but do not include offsetting receipts, which are recorded as negative budget authority and outlays.

sequestration: The cancellation of budgetary resources to enforce the discretionary spending caps and pay-as-you-go process established under the Budget Enforcement Act of 1990 and the Omnibus Budget Reconciliation Act of 1993. Sequestration is triggered if the Office of Management and Budget determines that discretionary appropriations exceed the discretionary spending caps or that legislation affecting direct spending and receipts increases the deficit. Changes in direct spending and receipt legislation that increase the deficit would result in reductions in funding for entitlements not otherwise exempted by law. Discretionary spending in excess of the caps would cause the cancellation of budgetary resources within the discretionary spending category.

short-term interest rate: Interest rate earned by a debt instrument that will mature within one year.

ten-year Treasury note: Interest-bearing note issued by the U.S. Treasury that is redeemed in 10 years.